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TAX CONSEQUENCES OF THE FAMILY PARTNERSHIP

By RICHARD W. CASE*

Perhaps no other income tax problem is so troublesome today as that presented by the family partnership cases. Certainly the ever-increasing number of opinions which have been written by the judges of the Tax Court and the Circuit Courts of Appeals bears grim witness to this fact. But in a larger sense the family partnership problem is only a part of an over-all picture, which, when viewed in its entirety, presents a continuing effort on the part of the Government to prevent tax avoidance through the use of the family unit. The related topics of the taxation of short term trusts¹ and family corporations,² discussed in detail elsewhere, should be kept in mind, therefore, as one attempts to solve the problem at hand. Moreover, the balancing factors of the protection of the Federal revenues and the right of every individual legally to minimize his tax burden should not be forgotten when dealing with the family partnership cases.

This paper presents an analysis of the problems which are the outgrowth of the family partnership status as that term is used in its common law sense. As a result, no attempt will be made to do more than comment upon those cases involving members of a family who are engaged in joint enterprises,³ pools,⁴ syndicates, or other unincor-

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¹ *Infra*, n. 148.

² Case, *Disregard of Corporate Entity in Federal Taxation—The Modern Approach* (1944) 30 Va. L. Rev. 398.

³ The distinction between joint enterprises, pools, syndicates, and other unincorporated organizations on the one hand, and common law partnership on the other, is a shadowy one. It has been suggested that the word

porated organizations.⁵ Since tenants in common, tenants by the entirety and property holders in marital communities are not ordinarily considered to be partnerships for tax purposes,⁶ they are without the scope of this paper.⁷ However, references will be made, at appropriate places, to those cases in which the courts have indicated that no technical common law partnership could exist between members of a family because of disabilities of local law, but where it has been held that income derived from property employed in a family business which was separately

"partnership" for tax purposes is the generic term, and that a joint enterprise, for instance, is merely one part of the whole. Harold G. Parker, 39 B. T. A. 423 (1939). The better-considered cases hold that a joint enterprise or joint adventure is an arrangement between two or more persons for the purpose of undertaking a single transaction. Thus, in *Motter v. Smyth*, 77 F.(2d) 77 (C. C. A. 10th, 1935) the Court held that an arrangement between a father and son was a joint adventure, where it appeared that they had agreed to cooperate for the purposes of selling a railroad, the father acting as contact man and the son supervising office detail. The Court stated that it was not necessary in such situations for the parties to the arrangement to furnish capital or services in equal amounts. See also *Thomas F. Kelley*, 9 B. T. A. 834 (1927); *H. S. Tuthill*, 22 B. T. A. 887 (1931); I. T. 2022, III—1 CUM. BULL. 9 (1924). In a few jurisdictions, the rule prevails that a husband and wife cannot be considered as partners in the same firm. Such disabilities of local law, however, have not generally militated against a taxpayer's position where the facts are clear that income from a business was actually earned by his wife or by property owned by her. In such cases, the income earned by a wife or her property has been taxed to her, and not to her husband. One theory upon which these cases have been based is to the effect that what would ordinarily be a business partnership in states allowing such a relationship between husband and wife will be considered a joint venture for tax purposes if local law prohibits a technical partnership between spouses. See *L. F. Sunlin*, 6 B. T. A. 1232 (1927).

A pool, as distinguished from a joint enterprise, has been held to have been in existence where parties contributed capital for the purposes of future investments. The continuing nature of the relationship seems to be the distinguishing characteristic. *First National Bank of Duluth, Adm.*, 13 B. T. A. 1069 (1928); *Claude Nolan*, 16 B. T. A. 1233 (1929) *semble*. For a case in which a pooling arrangement was held to be merely an anticipatory assignment of income, therefore remaining taxable to him who earns it, see *Walter P. Villere*, B. T. A. Memo. Op., Dkt. 106296 (April 7, 1942) *Aff'd per curiam Villere v. Commissioner*, 133 F.(2d) 905 (C. C. A. 5th, 1943).

⁵ In *Champlin v. Commissioner*, 71 F.(2d) 23 (C. C. A. 10th, 1934), the Court, in reversing the Board's determination that no partnership existed, placed its decision on the fact that a husband and wife had formed a "mining partnership" under local (Oklahoma) law, and held that this relationship should be recognized for tax purposes.

⁶ MERTENS, *LAW OF FEDERAL INCOME TAXATION* (1942) §35.02, p. 87.

⁷ It was contended by the Government that brothers, who held a portion of their father's estate as tenants in common, were taxable as partners under the phrase "other unincorporated organizations" found in §801 of the Revenue Act of 1934, in *Estate of Edgar S. Appleby*, 41 B. T. A. 18 (1940) *Aff'd on other grounds Commissioner v. Appleby's Estate*, 123 F.(2d) 700 (C. C. A. 2nd, 1941). This contention was rejected by the Board, and abandoned on appeal.

owned by a wife has been taxed to her and not to her husband.

Required Essentials in Family Partnership Cases.

A leading authority has commented that a working definition of the term "partnership" for tax purposes is exceedingly difficult, if not impossible, to state with any degree of accuracy.⁸ It is surprising to find, therefore, that it was not until 1932 that an attempted definition or classification of the term was forthcoming from Congress.⁹ However, the Code now provides,¹⁰ as did the Revenue Acts subsequent to 1932, that the term "partnership" includes:

"a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation."

The Code definition is not exclusive.¹¹ It has been suggested, moreover, that the Section was intended to clarify the confusion which had existed under prior Acts with respect to the time and manner of returning income from the operation of joint ventures, syndicates, pools and other similar organizations, and was not intended to present a working definition of such associations.¹²

If the Code is deficient in providing a useful definition of the term "partnership", this deficiency is more than overcome by the legion of cases which have dealt with the problem. While these cases have detailed a wide variety of factual patterns, they do establish, for the most part,

⁸ 6 MERTENS, LAW OF FEDERAL INCOME TAXATION (1942) §35.02, pp. 86-88.

⁹ Revenue Act of 1932, §1111 (a) (3).

¹⁰ Int. Rev. Code §3797 (a) (2).

¹¹ 6 MERTENS, LAW OF FEDERAL INCOME TAXATION (1942) §35.03, p. 89.

¹² H. R. REP. No. 708, 72nd Cong., 1st Sess. (1932), 1939-1 (Part 2) CUM. BULL. 495; SEN. REP. No. 665, 72nd Cong., 1st Sess. (1932), 1931-1 (Part 2) CUM. BULL. 538. Both reports indicate that confusion existed over the requirements of prior Acts as to the time and manner of returning income from the operations of joint ventures, syndicates, pools and similar organizations, and then proceed to deal only with syndicates. No expressed definition is set forth of the various associations which were included in the new Section. The reports conclude that the new provision will have the effect of requiring "syndicates" to file partnership returns.

certain fundamental requirements which must be present before a family partnership will be recognized. Granted that one travels on treacherous ground when an attempt is made to generalize for tax purposes, it is nevertheless believed that the requirements found in the majority of family partnership cases can be crystallized into rules which will be determinative of whether or not a true partnership exists between members of a given family, or whether the legal formalities entered into between the parties amount to nothing more than an attempt to reallocate income within a family unit.

The first requirement which must be present before a family partnership will be recognized for tax purposes is a finding that the parties have formed an organization which is to be used for some purpose other than merely as a device to reduce the surtax bracket of the chief income producing member of the family, whose economic position has remained unchanged as a result of the creation of the firm. Coupled with this requirement is the corollary that it must appear that the members of the family have formed a relationship in which they each have a mutual interest in the profits or losses of the enterprise. In the ordinary case, such findings might be sufficient to sustain the existence of a partnership. Family partnership cases, however, require in addition that at least one of two other prerequisites be met. The first of these is that if the firm receives its income chiefly from personal services, it must be shown that the family members supplied such services to the firm, with the understanding that the contributors were partners and not employees of the enterprise. The second additional prerequisite is to the effect that if capital is an important element in the production of firm revenues, it must be shown that each family member contributed as a partner to the firm either his own capital or valuable services which directly augmented partnership income.

The first requirement mentioned above relates to the creation of a firm for the purposes of saving personal taxes. To meet the impact of this prerequisite, the contention is

uniformly made by the taxpayer that a person should be able to adjust his property or business in any way he sees fit for the purpose of saving taxes, so long as he stays within the letter of the law. Before a decision can be reached on the applicability of the requirement, therefore, it is necessary to determine the exact character of the "tax saving" which has been the basis for the disregard of family partnerships.

The type of "tax saving" which has been held to be the basis for the disregard of family partnerships has as its end product the splitting of surtaxes by means of channeling income earned by one person or his property to another person in the same family group who was not responsible for its production, by means of the partnership device. It is not altogether accurate to state, therefore, that the requirement under consideration will foreclose the recognition of a family partnership merely because the firm was created for the purpose of saving personal taxes.¹⁸ It should be permissible, for instance, for a husband irrevocably and unconditionally to give one-half of the capital used in his business to his wife and for the parties thereafter to form a partnership which would result in a division of family income. However, before such a partnership will be recognized for tax purposes, it must appear that the husband has changed his economic position as a result of the gift of assets and the organization of the firm. If this has been done, it cannot be said that the parties have attempted to split the husband's surtax bracket by means of channeling income earned by him or his property to his wife through the partnership, because one-half of the income has been earned by property owned by the wife. Moreover, it should be permissible for members of a family who are stockholders in a family

¹⁸ The courts have stated on various occasions that if the parties formed a family partnership for legitimate business reasons, the mere fact that they knew a tax saving would result would not be grounds for disregarding the firm. Thus, in *Davis B. Thornton*, 5 T. C. , No. 13 (1945), a family partnership was recognized even though the predominant motive in establishing the firm was the taxpayer's desire to save Federal income taxes, where it appeared that another motive was to strengthen the credit of the business by making the wife, who owned a large estate, a member of the firm.

corporation which has been recognized for tax purposes,¹⁴ to dissolve the corporation and form a partnership for the purpose of avoiding the taxes which are incident to doing business in corporate form.¹⁵ In such cases, the partnership is formed to save the tax cost of doing business in a particular way, rather than to create a legal subterfuge for the purpose of splitting a tax bracket.¹⁶ This type of tax saving should not be the basis for disregarding a family partnership.¹⁷

¹⁴ Case, *Disregard of Corporate Entity in Federal Taxation—The Modern Approach* (1944) 30 Va. L. Rev. 389.

¹⁵ In this situation the end product is not the splitting of surtaxes, but an attempt by the parties to have income taxed only once instead of twice. If income from the family corporation has been legally distributed to stockholders, the same percentage of distribution should be made under the partnership arrangement. As a result, the creation of the partnership will not change the percentage of business profits received by each of its participants and it cannot be said that the plan was entered into for the purpose of shifting part of the tax burden to members of a family who did not earn the income in question. This distinction has been made in *Davis B. Thornton*, 5 T. C. , No. 13 (1945).

¹⁶ This reasoning is clearly recognized in *Tower v. Commissioner*, 148 F.(2d) 388 (C. C. A. 6th, 1945). There the Government attempted to sustain the Tax Court's determination that a family partnership should be disregarded on the grounds that the firm was created solely to save taxes. The facts showed that the tax saving in question resulted from the elimination of corporate taxes by means of dissolving a family corporation and the formation of a partnership. The Court stated that if the contention made by the Government were sound, then no matter what advantage there might be, taxwise or otherwise, in transforming a closely-held corporation into a partnership, such change would never, for tax purposes, be recognized. See also *Charles F. Goodwin, et al.*, T. C. Memo. Op., Dkts. 3343, 3344 (Oct. 9, 1944); *William J. Hirsch*, T. C. Memo. Op., Dkt. 2185 (Jan. 3, 1945).

¹⁷ Close questions will arise in those cases in which a taxpayer gives stock in a family corporation to his wife, and then dissolves the corporation. Here the answer must turn on whether or not the gift was absolute on its face, and in fact divested the taxpayer of all economic control over the subject matter of the gift. Thus, in *Jacob De Korse, et al.*, 5 T. C. No. 11 (1945) the Court refused to recognize a family partnership which was created by the giving of stock in a close corporation to members of the families of the two principal stockholders, coupled with a dissolution of the corporation and a transfer of its assets to the partnership. The Court reasoned that by viewing the transaction as a whole it was clear that the taxpayers did not intend to make out-and-out gifts of the assets of the business to the members of their families, but only intended to give them a portion of the income from the business for the purpose of avoiding income tax liability. See also *O. William Lowry*, 3 T. C. 730 (1944). On appeal, Circuit Court, Sixth Circuit; *R. W. Camfield*, T. C. Memo. Op., Dkt. 112451 (Feb. 9, 1941). On appeal, Circuit Court, Sixth Circuit. However, in *Davis B. Thornton*, 5 T. C. No. 13 (1945) the taxpayer made an unconditional and irrevocable gift of stock in a wholly owned corporation to his wife, which gave the wife the right to do what she pleased with the subject matter of the gift. Thereafter, the corporation was dissolved, and title to one-half of its assets was transferred to the wife. A partnership was then formed, the wife contributing the assets which stood in her name to the firm. The Court

Relatively few early cases recognized the principle that if a firm was formed merely to save personal taxes without changing the economic position of the head of a family, the partnership was not formed for a bona fide business purpose and should therefore be disregarded.¹⁸ Moreover, there was contrary authority.¹⁹ In *B. M. Phelps*,²⁰ the Board, in recognizing a family partnership for tax purposes, had no hesitancy in stating that it was immaterial that the apparent object of the reorganization of the firm was the reduction of surtaxes, the reason being that the taxpayers had the right to change their methods of doing business "as long as they kept within the spirit of the law".²¹ Even after the decision in *Gregory v. Helvering*,²² the Board was reluctant to disregard a family partnership solely on these grounds.²³ This was true even though the evidence supported a finding that the taxpayer had become concerned about increased Federal taxes, and had sought and received advice from his tax counselor to form a family partnership with his wife.²⁴ However, in sustaining family partnerships involving tax-conscious parties, the Board was careful to point to other considerations which would tip the scales in the taxpayer's favor.²⁵ More recently, the Tax Court has taken pains to point to the bona fide business purpose which motivated the formation of the firm before it would be recognized for tax purposes.²⁶

stated that it could find no such continuation of domination and control over the subject matter of the gift which would justify non-recognition of its reality. The partnership was sustained.

¹⁸ James H. Persons, 5 B. T. A. 716 (1926).

¹⁹ However, a finding by the Board that the parties entered into a family-partnership arrangement long before they realized that a tax advantage could be gained thereby was given weight in border-line cases. Leonard M. Gunderson, 23 B. T. A. 45 (1931).

²⁰ 13 B. T. A. 1248 (1928). This was one of the earliest cases in which the Board commented upon a contention advanced by the Government that the partnership was formed solely for the purposes to avoid surtaxes.

²¹ *B. M. Phelps*, 13 B. T. A. 1248, 1250 (1928).

²² 293 U. S. 465 (1935).

²³ Justin Potter, 47 B. T. A. 607 (1942). The Board did point out, however, that, read in its entirety, the record did not reveal a clear-cut plan on the part of the taxpayer to evade Federal income taxes.

²⁴ Walter W. Moyer, 35 B. T. A. 1155 (1937). The Board stated that an agreement or transaction was not rendered ineffectual merely because it was entered into or motivated by a purpose to avoid taxes.

²⁵ Sidney M. Harvey, B. T. A. Memo. Op., Dkt. 109298 (Oct. 14, 1942) *Cf.* Thomas M. McIntyre, 37 B. T. A. 812 (1938) (Partnership disregarded).

²⁶ J. D. Johnston, Jr., 3 T. C. 799 (1944); Benjamin Shander, T. C. Memo. Op., Dkt. 111788 (March 11, 1943); Julius Caesar Haley, T. C. Memo. Op.,

The rule which is applied today by the Circuit Courts of Appeals²⁷ and the Tax Court is undoubtedly to the effect that a family partnership will not be recognized if it has no real business function and if the only apparent purpose for its organization was an attempt to split the surtax bracket of the chief income producer of the family, whose economic position remained unchanged as a result of the formation of the firm.²⁸ In such cases, a finding that the partnership was formed primarily to save personal taxes, without a corresponding change in the economic position of the parties, will negative the existence of a true business purpose, and this is considered sufficient to invoke the *Gregory* principle.²⁹ Thus, in *A. L. Lusthaus*,³⁰ a taxpayer who had operated as a sole proprietor a retail furniture store, and who was advised by his lawyer and accountant to make his wife a partner in the business for the purpose of reducing his personal taxes, received as a tax evaluation of his activities a statement to the effect that:³¹

“Finally, the partnership emerged from the metamorphosis clothed in the outer garment of legal re-

Dkt. 5658 (Jan. 23, 1945). *But see* Sidney Nathan, et al., T. C. Memo. Op., Dkts. 102726, 102727, 102728, 102730 (May 14, 1943) for a case in which a family partnership was sustained even though the Tax Court recognized the fact that tax saving was one of the principal reasons motivating the formation of the firm.

²⁷ *Bradshaw v. Commissioner*, 150 F. (2d) 918 (C. C. A. 10th, 1945); *Grant v. Commissioner*, F. (2d) (C. C. A. 10th, 1945); *Earp v. Jones*, 131 F. (2d) 292 (C. C. A. 10th, 1942) *Cert. denied* 318 U. S. 764 (1943); *Tinkoff v. Commissioner*, 120 F. (2d) 564 (C. C. A. 7th, 1941) *Cert. denied* 314 U. S. 581 (1941). *See also* *Blalock v. Allen*, 56 F. Supp. 266 (M. D. Ga., 1944).

²⁸ *A. L. Lusthaus*, 3 T. C. 540 (1944) *Aff'd* *Lusthaus v. Commissioner*, 149 F. (2d) 232 (C. C. A. 3rd, 1945); *Clarence L. Fox, et al.*, 5 T. C. No. 26 (1945); *J. G. Fredeking*, T. C. Memo. Op., Dkt. 110082 (Oct. 21, 1943); *R. W. Camfield*, T. C. Memo. Op., Dkt. 112451 (Feb. 9, 1944) On appeal, Circuit Court, Sixth Circuit; *Edward J. Miller*, T. C. Memo. Op., Dkt. 3300 (March 18, 1944); *Stanley Bradshaw*, T. C. Memo. Op., Dkt. 334 (July 31, 1944) *Aff'd* *Bradshaw v. Commissioner*, 150 F. (2d) 918 (C. C. A. 10th, 1945); *Joseph W. Grant, et al.*, T. C. Memo. Op., Dkts. 407, 416 (August 3, 1944) *Aff'd* *Grant v. Commissioner*, 150 F. (2d) 915 (C. C. A. 10th, 1945); *Irwin J. Miller*, T. C. Memo. Op., Dkt. 2272 (Oct. 9, 1944) *Aff'd per curiam* F. (2d) (C. C. A. 2nd, 1945). The same rule had been applied by the Board in *Thomas M. McIntyre*, B. T. A. Memo. Op., Dkts. 107685, 109693 (July 25, 1942).

²⁹ *O. William Lowry*, 3 T. C. 730 (1944) On appeal, Circuit Court, Sixth Circuit.

³⁰ 3 T. C. 540 *Aff'd* *Lusthaus v. Commissioner*, 149 F. (2d) 232 (C. C. A. 3rd, 1945).

³¹ *A. L. Lusthaus*, 3 T. C. 540, 542 (1944).

spectability, but inwardly perhaps a little uneasy over the flimsiness of its undergarment of income tax alleviation."

Moreover, at least one case has indicated that the parties must combine for the purpose of conducting a "lawful" business.³² However, this would seem to be an unwarranted extension of the requirement, especially when it is considered that the income received in an unlawful business is fully taxable, and that for the most part the business is "unlawful" by virtue of some local law provision which should have no effect upon the taxability of the parties under the Federal income tax.

The corollary to the first requirement which must be present before a family partnership will be recognized for tax purposes is not peculiar to family firms, but is a general test which must be met by any partnership before its existence will be sustained. This requirement is, in effect, that it must clearly appear from the evidence that the parties have entered into a relationship in which they have a mutual interest in the profits or losses of the enterprise. The test stems from the fact that it is possible for members of a family to associate themselves in a common business undertaking on some plane other than that of a partnership status. For instance, a father and son might agree to conduct a mercantile business with the understanding that the son's compensation would be determined by a percentage of net profits. If such an arrangement were solely for the purpose of determining the amount of compensation that the son should receive, and in reality gave him no community of interest in the profits or losses of the firm with his father, no partnership has been created.³³

The requirement that all partners must have a mutual interest in the profits or losses of the enterprise has been

³² E. C. Ellery, 4 T. C. 407 (1944).

³³ The same result should be reached where a father wishes to make continuing gifts to his child to be paid from the profits of his business. Thus in *John W. Graham*, 8 B. T. A. 1081 (1927) *Aff'd* *Graham v. United States*, 44 F.(2d) 566 (C. C. A. 7th, 1930), a father and son agreed that the son should have for his own one third of the profits from a partnership composed of the father and his wife. The agreement further stipulated that the son's income should be reduced by one-third of any losses sustained by the business. The Board held that the son was not a partner.

taken from the common law. The Board has drawn from Chancellor Kent,³⁴ Story,³⁵ and definitions enunciated by the Supreme Court³⁶ in establishing this principle. It has been held that an arrangement whereby the taxpayer retained absolute discretion in the manner, method and amount of expenditures and the division of profits, deprived the remaining family partners of any community of interest in such profits, and as a result the partnership was disregarded.³⁷ Other cases have stressed the lack of a proprietary interest in profits in refusing to recognize a family partnership, where it appeared that the income received by a family member came through an agreement with the taxpayer rather than directly from the business.³⁸ Mutual liability for the loss of profits or capital should also be present before a family partnership is recognized for tax purposes. However, in at least one case, the Board has indicated that an expressed agreement to share losses was not essential to the existence of a firm.³⁹

Before a family partnership will be recognized for tax purposes, there must be present at least one of two other requirements in addition to the prerequisite discussed above. Both of these requirements depend to some extent

³⁴ John W. Graham, 8 B. T. A. 1081, 1083 (1927); R. C. McKnight, 13 B. T. A. 885, 888 (1928); Samuel J. Lidov, 16 B. T. A. 1421, 1425 (1929). This standard definition is as follows:

A contract of two or more competent persons to place their money, effects, labor and skill, or some or all of them, in lawful commerce or business, and to divide the profits and bear the loss in certain proportions.

³⁵ John W. Graham, 8 B. T. A. 1081, 1083 (1927).

³⁶ *Meehan v. Valentine*, 145 U. S. 611 (1892). The Court there stated that the essentials of a partnership were (p. 618):

The requisites of a partnership are that the parties must have joined together to carry on a trade or adventure for their common benefit, each contributing property or services, and having a community of interest in the profits.

The definition is accepted in the following family partnership cases: *M. L. Virden*, 6 B. T. A. 1123 (1927); *J. Howard Coombs*, 20 B. T. A. 1021 (1930); *Leonard M. Gunderson*, 23 B. T. A. 45 (1931); *Jasper Sipes*, 31 B. T. A. 709 (1934); *Irene McCullough, et al.*, T. C. Memo. Op., Dkts. 1710, 1711 (July 19, 1944).

³⁷ *T. L. Talley*, 22 B. T. A. 712 (1931) *Cf. Richard H. Oakley*, 24 B. T. A. 1082 (1931).

³⁸ *Ed Kasch, et al.*, 25 B. T. A. 284 (1932) *Aff'd Kasch v. Commissioner*, 63 F. (2d) 466 (C. C. A. 5th, 1933) *Cert. denied* 290 U. S. 644 (1933); *Robert S. Eaton*, 37 B. T. A. 283 (1938) *Aff'd without opinion Eaton v. Commissioner*, 100 F. (2d) 1013 (C. C. A. 2nd, 1939) *Cert. denied* 307 U. S. 636 (1939).

³⁹ *Jasper Sipes*, 31 B. T. A. 709 (1934).

upon the nature of the income-producing factor of the firm. The general rule is that if the profits of a partnership are derived chiefly from capital, it must be shown that the partners contributed to the firm capital owned by them, or services, with the understanding that such contributions were made as partners. However, if the chief source of firm income is derived from personal services, it must be shown that each partner contributed such services to the partnership as a partner.

In cases in which firm profits depend chiefly upon the use of capital and in which one member of a family has supplied no capital to the firm but has contributed services which were an important factor in the realization of that income,⁴⁰ with the understanding that such services were contributed as a partner,⁴¹ the partnership will be recognized for tax purposes. In such cases, the courts have adopted the sound policy of recognizing an agreement between members of a family to the effect that one of them would supply services to the firm in the capacity of a partner.⁴² A momentary reflection will reveal, moreover, that if this were not true the courts would have to take the position that they had the right to recast an agreement made between members of a family in a way which would be contrary to the terms of the understanding itself. Thus a wife should be considered the business partner of her husband even though she has contributed no assets

⁴⁰ This requirement rules out such services as entertaining a husband's business associate in the family home, or other purely social activities which might indirectly contribute to the success of the husband's business. Such services, "in so far as they relate to business at all, are of the same nature and character as those which might reasonably be expected of any woman having an interest in the success of her husband's business endeavors." *L. D. Simmons*, 4 T. C. 1012 (1945).

⁴¹ If services are contributed to a family business by the wife of the taxpayer under an agreement whereby the wife is a mere employee, such services cannot be relied upon to prove the existence of a partnership. *Avent v. Commissioner*, 76 F.(2d) 386 (C. C. A. 5th, 1935); *Francis Doll*, 2 T. C. 276 (1943) *Aff'd Doll v. Commissioner*, 149 F.(2d) 239 (C. C. A. 8th, 1945) *Cert. Applied* June 19, 1945.

⁴² Of course, the members of the family must prove by a preponderance of the evidence that such an agreement actually existed. As pointed out at another point in this paper, a great number of varying factors may be drawn upon for such purposes. Moreover, it should be kept in mind that in sending a notice of deficiency, the Government has in effect denied the existence of any such agreement, and the taxpayer has the burden of proof to show that it had been made and was in force.

of her own to the business, if the facts clearly show that she spent her entire time in rendering necessary services to the firm.⁴³ In such situations, border-line cases may develop as to whether or not such services are "necessary" or "directly contribute to the realization of partnership income".⁴⁴ However, the answers to these narrow points must, of necessity, turn on the facts of each particular case, and so no general rule can be stated with any degree of accuracy which would cover them all. In situations in which firm revenues do not depend primarily upon the use of capital but are conditioned upon the reputation,

⁴³ Frank E. Eyestone, 12 B. T. A. 1232 (1928) (Sons agreed to help pay off a mortgage); John Peters, 16 B. T. A. 895 (1929) (Sons agreed to leave part of their share of earnings in the firm); James N. Purse, 27 B. T. A. 725; Irene McCullough, et al., T. C. Memo. Op., Dkts. 1710, 1711 (July 19, 1944); M. W. Turner, et al., T. C. Memo. Op., Dkts. 2460, 2461 (Nov. 30, 1944). *See also* Sidney M. Harvey, B. T. A. Memo. Op., Dkt. 109298 (Oct. 14, 1942) (No technical partnership because of disabilities of Michigan law). *But see* E. C. Ellery, 4 T. C. 407 (1944) in which a wife contributed valuable services to a firm which was nevertheless disregarded because it was engaged in a business which was unlawful under state law.

⁴⁴ If a partnership derived its entire income from investments, services might neither be necessary nor directly augment the income of the firm. In such cases, a contention that services were contributed by a partner who had put no capital into the business would be a sham, and should not be a basis for a finding that a partnership existed for tax purposes. In the great majority of cases, however, capital is only the chief income-producing factor of the partnership. In any manufacturing business, for example, it is necessary to combine services in the form of managerial skill with capital before the enterprise can operate at all. In such situations, the question will arise as to the nature of the wife's services in relation to the over-all picture. It has been held, in numerous cases, that if a wife contributes her time to the performance of "office duties" such services will be partially determinative of the existence of the firm. Arthur Stryker, 17 B. T. A. 1033 (1929); Leonard M. Gunderson, 23 B. T. A. 45 (1931); J. Kammerdiner, 25 B. T. A. 495 (1932); George A. Croft, T. C. Memo. Op., Dkt. 1432 (Oct. 11, 1944). Unfortunately, these cases do not present a clear-cut answer to the question of whether or not "office duties", standing alone, will be sufficient to sustain a family partnership which receives its chief source of income from the use of capital, since in each case the wife also contributed some capital. It is believed, however, that a contribution of "office services" on a full time basis by a member of a family should be sufficient to sustain a family partnership whose chief income-producing factor is capital, if such services were contributed under a bona fide understanding that they were rendered as a partner, and not as an employee of the organization. On the other hand, it is doubtful whether the supplying of office duties would make the contributor a partner in a business which receives its chief source of revenues from personal services. It could hardly be questioned, for instance, that an attorney could not make his wife a partner for tax purposes on the grounds that she acted as his secretary. In such cases, the rule should be that each person engaged in the business should contribute or attempt to contribute some earning power to it by means of his own reputation, skill or personality, before he will be considered a partner in the enterprise.

skill or personalities of the persons conducting the business, a family member must show that he contributed personal services which directly augmented the partnership income before he will be considered a member of the firm for tax purposes.⁴⁵ It should be emphasized that the supplying of personal services by each member of the family is an absolute requirement in this type of case before they will be recognized as partners in a family business.

Where the existence of a family partnership depends solely upon the contribution of capital to the enterprise by a family member, the firm will not be recognized unless it can be shown that capital is an important element in the production of income and that the assets supplied by the family member were in reality his property and not that of another member of the same family group. The principal reason for the development of this requirement was to prevent the creation of family partnerships by means of an assignment to a family member of an interest in the income of a business as distinguished from an assignment of an interest in firm assets. The sub-partnership was condemned at an early date by the Board,⁴⁶ and the only

⁴⁵ H. J. Barton, 3 B. T. A. 1262 (1926); H. T. Loper, 12 B. T. A. 164 (1928); W. H. Simmons, 22 B. T. A. 1106 (1931); S. R. 6998, V—1 Cum. BULL. 268 (1926). See also Peter F. Loftus, T. C. Memo. Op., Dkt. 617 (Sept. 20, 1944), where the nature of the business was that of a "consulting engineer". The Tax Court was seemingly impressed with the necessity of capital in the business for the purpose of meeting a large payroll, and relied to some extent on *Humphreys v. Commissioner*, 88 F.(2d) 430 (C. C. A. 2nd, 1937). However, even if the business is considered as one deriving most of its income from personal services, the valuable services contributed by the wife should justify the result. It should be emphasized, moreover, that a contribution of capital and no services to a firm which derives the major part of its income from personal services will not be sufficient to make the contributor a partner in the firm. Thus in *Leo J. Feistel*, T. C. Memo. Op., Dkt. 1511 (Jan. 27, 1945) it was proved that a wife had contributed some capital to her husband's insurance business, and that as a result she was made a partner in the enterprise. The Court reasoned that the income of the business was derived chiefly from the personal services of the taxpayer and not from the use of capital, and therefore refused to recognize the wife as a partner, irrespective of her admitted contribution of capital to the firm. The same reasoning is used in *G. Elliott Krusen, et al.*, T. C. Memo. Op., Dkt. 750 (Aug. 3, 1944) *Aff'd per curiam* *Krusen v. Commissioner*, 148 F.(2d) 210 (C. C. A. 3rd, 1945); *D. H. McEachern*, 5 T. C. No. 4 (1945).

⁴⁶ A common pattern was that in which a husband, who was conducting his business as a partnership with a third party, sought to make his wife a sub-partner by giving her a percentage of his "interest" in the firm profits. Such arrangements were held not sufficient to make the wife a partner, and the husband remained taxable on his distributable share of firm profits. *Ormsby McKnight Mitchel*, 1 B. T. A. 143 (1924) *Aff'd*

family partnership case which has been considered by the Supreme Court held that it must clearly appear that the family members had an interest in the assets of the firm rather than a mere right to receive a part of its income, before the partnership could be recognized for tax purposes.⁴⁷

To aid analysis, it is convenient to divide this requirement into two parts. Initially, it must appear that capital is an important element in the production of firm income. Although this problem is beset with difficulty and pregnant with border-line situations, a majority of the cases should be capable of decision by an application of every-day knowledge. Thus, a law partnership, an accounting firm, a business receiving its income from commissions on sales made by its participants, or a partnership deriving its income chiefly from the personal efforts of one of its members should not ordinarily be considered as employing capital as a principal factor in the production of its revenues. On the other hand, a partnership formed to invest in real estate, stocks or bonds, a firm engaged in selling merchandise which it owns to the public, a partnership engaged in the manufacturing or processing of commodities for sale to the public, or a firm devoted to mining or the lumber business should be considered as engaged in a business in which capital is an important element in the production of income. In this connection, it should be recog-

Mitchel v. Bowers, 9 F.(2d) 414 (S. D. N. Y., 1925) *Aff'd* Mitchel v. Bowers, 15 F.(2d) 287 (C. C. A. 2nd, 1926) *Cert. denied* 273 U. S. 759 (1927); Yale Kneeland, 1 B. T. A. 150 (1924); Hudson M. Knapp, 5 B. T. A. 762 (1926); Samuel Kurzman, 8 B. T. A. 412 (1927); Sam H. Harris, 11 B. T. A. 871 (1928) *Aff'd* Harris v. Commissioner, 39 F.(2d) 546 (C. C. A. 2nd, 1930); J. Fred Staebler, 17 B. T. A. 1086 (1929) (decided under provisions of Michigan law); Houston Brothers, 22 B. T. A. 51 (1931). The same rule was applied after a taxpayer ceased to do business with the third party. George M. Cohan, 11 B. T. A. 743 (1928) *Aff'd* Cohan v. Commissioner, 39 F.(2d) 540 (C. C. A. 2nd, 1930). One case seems inconsistent. In C. R. Thomas, 8 B. T. A. 118 (1927) a taxpayer sold one-half of his interest in his partnership to his daughter for \$1500. The taxpayer's partner never knew of the interest held by the daughter. The Board held that while the daughter did not become a partner in the business, it did not follow that the taxpayer should be taxed on his entire distributive share. It was reasoned that the daughter had purchased a share in the corpus of the taxpayer's partnership interest, as distinguished from a mere right to participate in future earnings. See also G. C. M. 3412, VII—1 Cum. BULL. 106 (1928).

⁴⁷Burnet v. Leininger, 285 U. S. 138 (1932).

nized that the mere fact that a partnership owns a large amount of capital which is not actively employed for the purpose of earning income is not determinative. While this might be a factor to be taken into consideration, the real question is whether the income was earned primarily by means of the personalities, skill or reputation of the persons conducting the business, or was realized from the use of capital which has been skillfully employed for the purposes of making money.⁴⁸

It is not altogether astonishing to find that cases dealing with this phase of the problem have produced irreconcilable conflicts. In *Humpherys v. Commissioner*⁴⁹ the Court sustained a family partnership for tax purposes where the nature of the business was the practice of tax law by attorneys and accountants. This result was reached even though the taxpayers' wives were neither lawyers nor accountants and contributed no services to the partnership, the Court resting its decision upon the fact that the wives had contributed all of the initial capital to the enterprise.⁵⁰ It is doubtful whether the *Humpherys* case should be followed today, and certainly its doctrine should not be extended.⁵¹ Moreover, the courts should consider in all cases in which *Humpherys v. Commissioner* is urged

⁴⁸ In *Clarence L. Fox, et al.*, 5 T. C. No. 26 (1945) it appeared that the sole source of income of the business had at all times been commissions received by two partners for their services as agents for certain woolen mills. The firm was characterized as one in which the earnings were attributable to the services of the taxpayers, irrespective of the fact that it owned \$85,000 worth of "Upholstery Designs". See also *D. H. McEachern*, 5 T. C. No. 4 (1945). In determining the chief source of firm revenues, moreover, good will should not be considered as capital. A law partnership might be said to have "good will" even although it employed only a modest amount of actual capital in the course of its practice. However, it could not be said that this type of "capital" would support a partnership for tax purposes between one of the members of the firm and his spouse who was a housewife.

⁴⁹ 88 F.(2d) 430 (C. C. A. 2nd, 1937).

⁵⁰ The Court was influenced by the fact that the partnership employed a large staff of personnel, and that the funds to compensate the firm's employees had been advanced, in the first instance, by the wives of the taxpayers.

⁵¹ An academic speculation might lead to the conclusion that had *Humpherys v. Commissioner* reached the Circuit Court after the decision of the Supreme Court in the *Dobson* case, the result would have been the other way. The reason for this lies in the fact that the Board had found, *Adrian C. Humpherys*, 33 B. T. A. 1081 (1936), that "the picture here presented * * * is that of a partnership deriving its income from personal services". Such a determination would, of course, not be disturbed today, if there was sufficient evidence in the record to justify the finding.

too strongly by tax-conscious litigants that in that case the Government apparently conceded the existence of the firm on appeal.⁵² In more recent decisions, the Circuit Courts of Appeals have had no difficulty in finding that family partnerships devoted to the accounting⁵³ or insurance business,⁵⁴ were in reality personal service partnerships, and that they did not require capital for the purposes of producing their income.

Where firm income is the product of a combination of the use of capital and the services of one or more of its members, more extensive tests have been drawn upon to determine the importance of capital in the production of such income. In these cases, which are by far the most troublesome, the result has generally been obtained by means of a comparison of the total income received by the partnership to the total capital employed in its production. The Tax Court has pointed out that capital will not be considered important in the production of firm income if the facts show that net profits are consistently several times the capital invested.⁵⁵ This is true even though the firm employed technicians who rendered services from field offices located in several states.⁵⁶ Thus, in *M. M. Argo*⁵⁷ the Tax Court found that partnership income was produced chiefly from personal services, where the facts clearly showed that the firm's annual earnings over a period of years were in excess of fifty per cent. of the entire capital invested. In other cases, the Court has characterized income as being produced "mainly" or "predominantly" from personal services to negative the contention that capital was the chief income-producing factor.⁵⁸ However, family partnerships have been recognized

⁵² *Humpherys v. Commissioner*, 88 F.(2d) 430, 432 (C. C. A. 2nd, 1937).

⁵³ *Tinkoff v. Commissioner*, 120 F. (2d) 564 (C. C. A. 7th, 1941) *Cert. denied* 314 U. S. 581 (1941).

⁵⁴ *Earp v. Jones*, 131 F. (2d) 292 (C. C. A. 10th, 1942) *Cert. denied* 318 U. S. 764 (1943).

⁵⁵ *L. D. Simmons*, 4 T. C. 1012 (1945).

⁵⁶ *Ernest R. J. Waldburger*, B. T. A. Memo. Op., Dkt. 103444 (Sept. 30, 1941) *Aff'd per curiam Waldburger v. Commissioner*, 131 F.(2d) 598 (C. C. A. 2nd, 1942).

⁵⁷ 3 T. C. 1120 (1944) *Aff'd on other grounds Argo v. Commissioner*, 150 F. (2d) 67 (C. C. A. 5th, 1945).

⁵⁸ *H. G. Whittenberg, Sr.*, T. C. Memo. Op., Dkt. 2778 (Sept. 13, 1944).

for tax purposes where the wife contributed no services to the enterprise even though the annual earnings of the firm were more than four times the total capital invested.⁵⁹ It is impossible to square the results in these cases, but it would seem that to the extent of the inconsistency, the approach used in *M. M. Argo* is perhaps the sounder one.

The second part of the requirement which should be met where recognition of a family partnership is sought solely on the grounds that members of a family have contributed capital to the enterprise is that it must be proved that the capital in question was, in fact, owned by the partner who contributed it.⁶⁰ If the Government can show, for instance, that the capital which was purportedly contributed to the partnership by a wife was in reality owned by her husband, the firm will be disregarded for tax purposes. While the question in controversy is relatively easy to state, namely what person was the true owner of certain assets which had been supplied to a family business, the solution is perhaps the most difficult to reach of any in the family partnership cases. This complexity stems from the definition of the term "ownership" when used taxwise, and from the varied and conflicting tests which have been employed by the courts in determining whether or not a person actually "owned" part of the capital used in a family partnership.

There is no particular difficulty involved in those cases in which a member of a family has contributed capital to a business which came to him from sources other than by means of gifts from another member of the same family. Thus a wife should be regarded as the business partner

⁵⁹ R. C. Bennett, B. T. A. Memo. Op., Dkt. 101715 (Sept. 2, 1941).

⁶⁰ Moreover, it must clearly appear that the capital was contributed as a partner, and not as a creditor of either the partnership or of one of the members of the lender's family. If the contribution of capital takes the latter form, no family partnership exists, even though it might be said that the lender has an equitable interest in the assets of the firm. *M. A. Long*, 8 B. T. A. 737 (1927); *J. Howard Coombs*, 20 B. T. A. 1021 (1930); *E. W. Battleson*, 22 B. T. A. 455 (1931). However, it does not necessarily follow that a husband will be taxed on the entire income of a business where no family partnership is recognized, if it can be shown that part of the capital of the enterprise was owned by the wife. *Max German*, 2 T. C. 474 (1943); *L. C. Binford*, T. C. Memo. Op., Dkt. 4386 (June 18, 1945.)

of her husband in a family enterprise which derives its chief source of revenue from the employment of capital, if she has contributed assets earned as a result of her own labor, or money left to her from her father's estate.⁶¹ In such cases it is generally true that the husband has no legal claim to the capital contributed by the wife, and its independent ownership is not questioned. The same result should be reached where a wife borrows capital for the purposes of going into business with her husband, if the facts clearly show that the wife's credit was the true basis for the loan.⁶²

In the great majority of cases, however, capital contributed by one member of the family has been either "given" or "sold" to him by another member of the same family group.⁶³ It is at this point that the real problem takes shape. As stated above, the pivotal question is whether or not the assets were owned by the person who purportedly contributed them to the business. In an attempt to declare a general rule which would determine whether or not an effective gift of such assets had been made by one member of a family to another, the Tax Court has stated that in addition to the ordinary requirements

⁶¹ *Montgomery v. Thomas*, 146 F.(2d) 76 (C. C. A. 5th, 1944); *M. L. Virden*, 6 B. T. A. 1123 (1927); *E. L. Kier*, 15 B. T. A. 1114 (1929); *H. D. Webster*, 4 T. C. , No. 138 (1945). The same result has been reached in cases dealing with Michigan law, under which no technical partnership could be created between the spouses. *R. E. Wing*, 15 B. T. A. 1028 (1929).

⁶² *H. D. Webster*, 4 T. C. , No. 138 (1945); *William J. Hirsch*, T. C. Memo. Op., Dkt. 2185 (Jan. 3, 1945). In *J. E. Biggs, Sr.*, 15 B. T. A. 1092 (1929) the entire capital required for a business was borrowed jointly by the taxpayer, a business associate and their respective wives. The Board found that a partnership for tax purposes had been created even though the wives contributed no services. However, in *J. G. Fredeking*, T. C. Memo. Op., Dkt. 110082 (Oct. 21, 1943) a wife purchased a share in her husband's business by borrowing \$3500 without security from a bank, the loan being approved by the husband and his brother, two of four bank officers who passed on such matters. The Court stated that the facts surrounding the granting of the loan clearly showed that the credit of the taxpayer's wife was unimportant, and that the scheme was one to avoid taxes.

⁶³ It is believed that the taxpayer should decide before his case is tried whether he will contend that he has "given" or "sold" assets to a member of his family. The reason for this is that if the contention is made that the property was sold by one member of a family to another, the court might find that title thereto remained in the taxpayer, on the ground that no technical sale had taken place, even though the evidence pointed to the fact that a gift of the assets had been made. See *W. P. Sewell, et al.*, T. C. Memo. Op., Dkts. 112298, 112299, 112339 (Feb. 7, 1944).

for gifts *inter vivos*,⁶⁴ it must appear that there was present a clear and unmistakable intention on the part of the donor irrevocably to divest himself of title, dominion and control of the subject matter of the gift; that there was an irrevocable transfer of present legal title and of the dominion and control of the gift to the donee and a complete divestiture of those attributes of ownership by the donor; and that there was a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it.⁶⁵ Reduced to its lowest terms, the Tax Court has stated that the donor must surrender all indicia of ownership and all control over the asset before the gift will be recognized.

In determining whether or not one member of a family has surrendered all the indicia of ownership and control over assets which he has given to a member of his family and which have been contributed by the donee to the partnership, the courts should be careful to construe the deed of gift and the partnership agreement together. This follows from the fact that the making of the gift and the formation of the partnership are usually related parts of one transaction, and also from the fact that both the terms of the deed of gift and the partnership agreement may bear on the question of continued control. Thus even although a gift which is evidenced by a deed is absolute on its face, the courts should not isolate that transaction but should consider it with the terms of the partnership agreement, in order to determine whether or not the family member in reality had all of the indicia of ownership and control over the asset which he has contributed to the firm.⁶⁶

⁶⁴These include: (1) that the donor was competent to make the gift; (2) that the donee was capable of taking the gift; and (3) an acceptance of the gift by the donee.

⁶⁵Frank J. Lorenz, 3 T. C. 746 (1944) *Aff'd per curiam* Lorenz v. Commissioner, F.(2d) (C. C. A. 6th, 1945); Francis E. Tower, 3 T. C. 396 (1944) *Rev'd* Tower v. Commissioner, 148 F.(2d) 388 (C. C. A. 6th, 1945); L. C. Binford, T. C. Memo. Op., Dkt. 4386 (June 18, 1945).

⁶⁶The better rule would seem to be that the gift of assets must be absolute. For instance, no gift of capital should be recognized if it is subject to a possibility of reverter to the donor in the event that the donee should no longer be the donor's wife, or should attempt to convey her interest in the capital of the firm to a third party. But there is early authority to the contrary. L. S. Cobb, 9 B. T. A. 547 (1927). It is doubtful whether the same rule should apply to gifts made upon the condition that the

A careful study of the recent cases⁶⁷ will reveal that a majority of them have in substance applied the tests outlined above. In *Justin Potter*⁶⁸ the taxpayers, members of an existing partnership, made, with the consent of their partners, irrevocable and unconditional gifts of part of their partnership interest to their minor children. At a later time, but before any question was raised by the Commissioner with respect to the gifts of partnership interests to the children, the business of the partnership was incorporated, and the children received stock and notes in proportion to their undivided interests in the firm property. The Board recognized that the taxpayers exercised some control over the property, but held, in sustaining the partnership, that the control was that of a natural guardian at law, and not that of an owner of assets.

A number of cases have sustained family partnerships in which the assets contributed by one family member were "given" or "sold" to him by another member of his family if it clearly appeared that each party had all of the inci-

donee will contribute the subject matter thereof to a family partnership which is to be formed. In these cases, the gift becomes absolute the second the condition subsequent is complied with. Thereafter there is no possibility of reverter to the donor, and if the donee is otherwise free to control his interest in the firm and the property is free from the economic dominance of his family member, the gift should be recognized. *Tower v. Commissioner*, 148 F. (2d) 388 (C. C. A. 6th, 1945). However, the fact that a gift is made upon such conditions might prove, in appropriate cases, that the parties intended to form a family partnership solely for the purpose of reducing the personal income tax burden of the chief income-producing member of the family without changing his economic position. A finding to this effect is, of course, sufficient basis to disregard the partnership.

⁶⁷ Some of the earlier cases were extremely liberal in holding that one member of a family had given or sold assets to another member of the same family which, in turn, had been contributed by the latter to a family business. Thus, in *Millard D. Olds*, 15 B. T. A. 560 (1929) *Aff'd Commissioner v. Olds*, 60 F. (2d) 252 (C. C. A. 6th, 1932) the taxpayer, the sole owner of a dock and lumber business, "sold" a one-fourth interest in his enterprise to each of his two daughters and received in payment a \$400,000 demand note. The partnership agreement, signed by the taxpayer and his daughters, provided that the business should be conducted by the taxpayer in his uncontrolled discretion, that the daughters could draw firm profits only in the amount that the taxpayer wished to give them, and that the daughters could inspect the partnership books at any time and if dissatisfied with the business could withdraw therefrom and have their notes returned by the taxpayer. The partnership was recognized. For other early liberal cases, see *Richard H. Oakley*, 24 B. T. A. 1082 (1931); *N. H. Hazlewood*, 29 B. T. A. 595 (1933); *Walter W. Moyer*, 35 B. T. A. 1155 (1937).

⁶⁸ 47 B. T. A. 607 (1942).

dences of ownership over his respective share.⁶⁹ In this respect, the right of each partner to assign his interest in the firm has been taken as a strong indication that he had complete dominion and control over his share of the partnership assets.⁷⁰ Moreover, the retention of an unlimited power on the part of one member of the family to conduct the business as he sees fit has not been held to be the type of control which prevents a finding that an irrevocable gift of partnership assets has been made. Partnerships have been recognized even though the firm agreements provided that one member of the family should have exclusive control of the business so far as its finances were concerned, and also should have absolute power to distribute profits or retain them in the firm as a credit on the respective accounts of the partners.⁷¹

The Tax Court has been consistent in holding that if the existence of a family partnership depends upon the contribution of capital by each of its members, the firm will be disregarded if the assets contributed by one family member were in reality owned by another member of the same family group. In this respect, gifts of partnership interests are disregarded if the purported transfer failed to change the donor's economic position in any material way.⁷² In reaching this result, the Court has often pointed to the fact that the family business was carried on in exactly the same way after the formation of the partnership as it had been before its creation.⁷³ Other cases, in disregarding family partnerships, have emphasized the complete domin-

⁶⁹ J. D. Johnston, Jr., 3 T. C. 799 (1944); M. W. Smith, 3 T. C. 894 (1944). See also I. T. 1744, II—2 CUM. BULL. 179 (1923).

⁷⁰ Sidney Nathan, et al., T. C. Memo. Op., Dkts. 102726, 102727, 102728, 102730 (May 14, 1943).

⁷¹ Robert P. Scherer, 3 T. C. 776 (1944). However, the agreement also provided that upon the termination of the partnership there would be a just and true accounting for firm profits. It thus appears that the control reserved was over the management of the business, as distinguished from control over the economic incidence of the interest in the firm held by other members of the family.

⁷² This was true even though the wife performed some services for the enterprise. A. L. Lusthaus, 3 T. C. 540 (1944) *Aff'd* Lusthaus v. Commissioner, 149 F. (2d) 232 (C. C. A. 3rd, 1945).

⁷³ R. W. Camfield, T. C. Memo. Op., Dkt. 112451 (Feb. 9, 1944) On appeal, Circuit Court, Sixth Circuit; Joseph W. Grant et al., T. C. Memo. Op., Dkts. 407, 416 (August 3, 1944) *Aff'd* Grant v. Commissioner, F. (2d) (C. C. A. 10th, 1945).

ion and control retained by one member of a family over the power to determine and distribute profits as distinguished from the power to run the business as the managing partner.⁷⁴ The absence of the power to make unlimited withdrawals by a family member has been held to prove that he had no interest in the assets of a partnership.⁷⁵ However, in reaching these conclusions, it has uniformly been stated that each case must depend upon its own facts, and for this reason no concrete rules which would apply in all cases have been laid down with respect to whether or not one member of a family has surrendered sufficient control over firm assets to constitute another member of the same family their owner.⁷⁶

Granted that each member of a family has contributed assets owned by him to a family partnership, the question remains as to whether or not the partners should be taxed on their distributive share of firm income under the partnership agreement or on the amount of income which bears the same relation to the total firm income as the capital contributed bears to the total firm capital. An illustration is desirable. Assume that a husband and wife, with no intention to avoid surtaxes, have formed a partnership in which capital is an important element in the

⁷⁴ O. William Lowry, 3 T. C. 730 (1944) On appeal, Circuit Court, Sixth Circuit. In Carl P. Munter et al., 5 T. C. , No. 6 (1945), it was held that an unlimited power to fix the salaries of the managing partners which had been retained by those partners was in effect a retained power to control the amount of firm profits which might be distributed in the future. Such power was held to constitute sufficient economic control to justify the disregard of the partnership for tax purposes.

⁷⁵ Frank J. Lorenz, 3 T. C. 746 (1944) *Aff'd per curiam* Lorenz v. Commissioner, 148 F. (2d) 527 (C. C. A. 6th, 1945); Stanley Bradshaw, T. C. Memo. Op., Dkt. 334 (July 31, 1944) *Aff'd* Bradshaw v. Commissioner, F. (2d) (C. C. A. 10th, 1945).

⁷⁶ A case which illustrates the type of continued control which has been condemned by the Tax Court is Camiel Thorrez, 5 T. C., No. 8 (1945). There "gifts" of partnership interests were made by the partners of an existing firm to members of their families. The "gifts" provided that their subject matter, the partnership interest, could not be disposed of by the donees without first offering them to the other partners at their appraised value, and further that they could not be disposed of to any outsider except upon approval of the partners. Thus the donors were in a position to prevent any disposition of such interests by refusing to purchase them themselves and by refusing to approve a sale to any outsider. The Court held that no completed gift had been made by the taxpayers to the members of their families, and consequently that no contributions of capital had been made by the latter to the family firm.

production of firm revenues. Further assume that the wife performs only nominal services for the firm, but has contributed \$10,000 to its capital which had been irrevocably given to her by the husband. If the husband has contributed \$90,000 to the partnership and if firm income, which under the partnership agreement is to be divided equally, is \$6000, should the wife be taxed on \$3000 or on \$600?

The answer to this problem depends upon a construction of the Code and the Regulations. It has been held that if no partnership has been formed by the parties, they may be taxed on the amount of income which bears the same relationship to the total income of the business as the capital contributed by them bears to the total capital used in the enterprise.⁷⁷ However, where a partnership has been created, the Code and Regulations provide that each partner should be taxed on his distributive share of firm income.⁷⁸ If an inequitable result exists because of

⁷⁷ An interesting and novel approach to this problem is Max German, 2 T. C. 474 (1943). There the taxpayer and his wife had worked together in various enterprises, each contributing equally to capital and services until 1930. During this period, the fruits of the spouses' joint endeavors were invested and reinvested in various businesses conducted by them. After 1930, the wife contributed few if any services, but the husband, with the aid of the capital which had been realized by means of joint effort, continued to engage in a "ham" business. In 1940, the husband and wife entered into a written partnership agreement with respect to this business. The Tax Court held that no partnership status existed between the taxpayer and his wife. However, two important facts were recognized. First, it was clear that some of the income was derived from capital, which was at least partially the property of the wife. Secondly, it was found that the entire income was not attributable to the use of capital alone, but to a substantial degree to the personal services of the taxpayer. The Court then held that although no partnership status existed, the income which could be allocated to the capital owned by the wife should not be taxed to the taxpayer. It was pointed out that the taxpayer had not put into the record facts or figures from which the capital contributed by the wife or the profits which might be allocated thereto could be determined with any degree of exactness. However, the Court, on its own motion, made such an allocation on the basis of 75% to the husband and 25% to the wife. The case reached an undoubtedly equitable result, but in strict theory may violate the rule requiring the taxpayer to carry the burden of proof. In this respect, the impact of the rule in *Helvering v. Taylor*, 293 U. S. 507 (1935) is obvious.

⁷⁸ *William F. Fischer*, 5 T. C. , No. 58 (1945); *Harriet A. Taylor et al.*, 2 B. T. A. 1159 (1925). The contention has been revived that members of a family partnership should be taxed on an amount of income which bears the same relation to firm profits as capital invested by the taxpayer bears to total firm capital. This theory of determining the taxability of family partners was rejected in *William J. Hirsch*, T. C. Memo. Op., Dkt. 2185 (Jan. 3, 1945). In the course of its opinion, the Tax Court stated that in certain cases, where individuals conducting a

this situation, it should be changed by an amendment to the Code and Regulations. Moreover, it is doubtful that a partnership whose chief income-producing factor is capital would be sustained by the courts if the facts showed that a family member contributed only a nominal amount of his own capital and no service to the firm, but claimed an equal division of its profits. Such proof would be a strong indication of the fact that the parties had attempted to form a partnership for the purpose of avoiding surtaxes, without changing the economic position of the financial head of the family, and this should be enough to justify its disregard for tax purposes.

Character of the Evidence.

The maze of seeming conflict and inconsistency which has been the outgrowth of the decisions dealing with the family partnership problem may best be explained on the ground that by and large each case has been decided on the peculiar facts which it has presented. Perhaps no other observation has been made so often, in cases dealing with this topic, as the statement that the family partnership problem is, for the most part, a question of fact; and if a common theme can be found in such cases, it is to the effect that the sum of all of the facts introduced presents the touchstone for decision. Granted that an orderly presentation of fact is of considerable importance in all tax

business were husband and wife, consideration should be given to the respective contributions of the parties of service and money to the business. It was observed, however, that the Tax Court had never held that the distributive shares of income should be allocated in accordance to capital contributed where (1) there was a partnership recognized for tax purposes and (2) there was adequate evidence that both the husband and the wife had contributed something to the capital of the business or had made contributions to services, or both. In *L. C. Binford*, T. C. Memo. Op., Dkt. 4386 (June 18, 1945) the taxpayer, the sole owner of a night club, executed a deed which conveyed one-half of the interest of the real estate used in operating the business to his wife. Concurrently, representations were made by the taxpayer to his brother, his secretary and his attorney that the wife had a one-half interest in the business. The Tax Court held that no absolute gift of a one-half interest in the business had been made by the taxpayer, and that as a result no partnership existed between the spouses. It was recognized, however, that the wife owned one-half of the real estate used by the business. Based on a fair market value of the realty at the date of the gift, the Tax Court determined a rental for the property, and one-half of that sum was allocated to the wife as her separate income.

litigation,⁷⁹ it becomes necessary to emphasize at this point that the common theme in the family partnership cases makes an orderly presentation of fact of paramount importance in that type of litigation. For this reason, every practitioner who is faced with the trial of a family partnership case should be well grounded in the type and character of evidence which is best calculated to result in an ultimate finding in favor of his client.

Before a trial lawyer can present the facts of his case in an orderly fashion, he must be fully apprised of the basic and underlying legal issues at stake. In family partnership cases, the ultimate issue is to whom certain income should be taxed. In refusing to accept a return as filed by adding to the income there reported additional income which had been reported by a third person, the Commissioner in effect contends that the unreported item is owned by and should be reported by the taxpayer. The burden of proof then falls upon the taxpayer to disclaim ownership of the unreported item, and this he does by attempting to establish that the income in question is

⁷⁹ This is of course emphasized by *Dobson v. Commissioner*, 320 U. S. 489 (1943). As to whether the *Dobson* case merely reiterated the finality of the fact-finding powers of the Tax Court, or went one step further by giving a presumptive correctness to its rulings on questions of law, see: Paul, *Dobson v. Commissioner: The Strange Ways of Law and Fact* (1944) 57 Harv. L. Rev. However, the recent decision in *Bingham's Trust v. Commissioner*, 65 S. Ct. 1232 (U. S. 1945), is at least an indication that Internal Revenue Code §1141 (c) (1) does not make the Tax Court the final arbiter of the issue of whether or not its own decisions on questions of law are right or wrong. It would thus seem clear that if the Circuit Courts of Appeals accept the findings of fact made by the Tax Court, they are free to reverse on any mistaken application of law. The Tax Court, in a number of recent family partnership cases, has included in its finding of fact conclusions to the effect that the parties did or did not create a firm which would be recognized for tax purposes. *Murphy Shannon Armstrong*, 1 T. C. 1008 (1943); *Irwin J. Miller*, T. C. Memo. Op., Dkt. 2272 (Oct. 9, 1944); *George A. Croft*, T. C. Memo. Op. Dkt. 1432 (Oct. 11, 1944); *M. W. Turner et al.*, T. C. Memo. Op., Dkts. 2460, 2461 (Nov. 30, 1944). This practice has been condemned by taxpayers who have contended that such findings go to the root of the case and could only have been intended to preclude an appeal to the Circuit Courts of Appeals. Brief for Petitioners, p. 76, *Armstrong v. Commissioner*, 143 F. (2d) 700 (C. C. A. 10th, 1944). Because many family partnership cases are capable of disposition on appeal on the authority of the *Dobson* case, it would seem that this objection has some merit. Cases which have been affirmed on authority of *Dobson v. Commissioner*, are: *Lorenz v. Commissioner*, 148 F. (2d) 527 (C. C. A. 6th, 1945); *Lusthaus v. Commissioner*, 149 F. (2d) 232 (C. C. A. 3rd, 1945); *Supornick v. Commissioner*, 150 F. (2d) 110 (C. C. A. 8th, 1945); *Miller v. Commissioner*, 150 F. (2d) 823 (C. C. A. 2nd, 1945).

owned by a third person. To shift this incidence of ownership, the taxpayer relies upon the existence of a legal status, the partnership, and attempts to prove that a third party, a member of his family, is a member of that partnership. To meet the taxpayer's argument, the Commissioner joins issue on the existence of the partnership status for tax purposes, and contends that the formal relationship between the parties is merely an attempt to reallocate income within a family unit.

No one fact is ever taken as conclusive of the existence of a family partnership status. The ultimate conclusion can only be reached after a careful weighing of all the evidence and a thoughtful consideration of all the testimony. Such intangible factors as the demeanor of the taxpayer's witnesses on the stand may be given consideration. Indeed, it has been suggested that what would be sufficient evidence to satisfy one judge would not be sufficient to satisfy another.⁸⁰ The undertone of the entire proceeding may have its effect. Cases illustrate the point, for instance, that if a hearing is conducted throughout with a freedom from suggestion that personal tax avoidance has motivated the formation of the partnership, less actual evidence is required to prove the partnership status than where tax-conscious persons are brought to account.⁸¹

Chief among the evidential prerequisites in any family partnership case is proof of the actual agreement which existed between the taxpayer and the members of his family.⁸² Since the best evidence of the existence of such an agreement is a written instrument which incorporates its terms, it is not surprising to find that the decisions have

⁸⁰ Paul, *Partnerships in Tax Avoidance* (1945) 13 Geo. Wash. L. Rev. 121.

⁸¹ Compare the case of *J. G. Fredeking*, T. C. Memo. Op., Dkt. 110082 (Oct. 21, 1943), in which the Court refused to sanction a family partnership although enough "technical" evidence was in the record, with *Benjamin Shander*, T. C. Memo. Op., Dkt. 111788 (March 11, 1943), where no personal tax saving motive was developed, but where the parties produced a smaller degree of formal evidence than is usually required.

⁸² It is fundamental that the contract between the parties must be a "partnership" agreement. Where, for instance, the agreement is entered into for the purposes of settling accounts between members of a family, no partnership has been formed, even though the amount of money a member of the family was to receive was measured or determined by the earnings of a family business. *Frank S. Delp*, T. C. Memo. Op., Dkt. 110120 (May 12, 1943).

at times emphasized the weight to be accorded written articles of partnership. Perhaps it is safe to generalize that in some of the earlier cases decided by the Board upholding the existence of family partnerships, the presence of a written agreement received more emphasis than would be accorded to it today.⁸³ In at least two series of litigations, the Board refused to recognize the existence of family partnerships when the only proof consisted of oral statements of the taxpayer's witnesses; but in later cases, involving the same partnerships, the status was given recognition on the strength of written articles which had not been considered in the earlier proceedings.⁸⁴ More recently, the Tax Court has indicated that it was still willing to consider the presence of a written agreement as an important evidentiary factor in sustaining a family partnership.⁸⁵

Although given considerable weight as proof of the existence of a family partnership, the presence of a written agreement is never considered to be conclusive that the status exists.⁸⁶ This is especially true in those situations in which a partnership derives all or most of its income from the personal services of the taxpayer.⁸⁷ In such cases, it is a

⁸³ R. A. Bartley, 4 B. T. A. 874 (1926); L. S. Cobb, 9 B. T. A. 547, (1927); E. L. Kier, 15 B. T. A. 1114 (1929); R. E. Hinshaw, 16 B. T. A. 1236 (1929).

⁸⁴ In G. M. Harrington, 10 B. T. A. 92 (1928), the Board stated that the taxpayer was required to introduce evidence to overcome the presumptive correctness of the Commissioner's determination, and that in its opinion no such evidence had been introduced to establish the partnership relationship between the taxpayer and his wife. However, in Glenn M. Harrington, 21 B. T. A. 260 (1930), the same taxpayer, on exactly the same facts as he had introduced in the previous case, with the addition thereto of a written agreement of partnership, was successful in establishing the partnership status. To the same effect, compare J. Howard Coombs, 20 B. T. A. 1021 (1930) with Elizabeth M. Coombs et al., 25 B. T. A. 1320 (1932).

⁸⁵ M. W. Smith, 3 T. C. 894 (1944). Here both the gift of capital by the husband to the wife and the partnership agreement were in writing.

⁸⁶ Samuel J. Lidov, 16 B. T. A. 1421 (1929); T. L. Talley, 22 B. T. A. 712 (1931); Harry C. Fisher, 29 B. T. A. 1041 (1934) *Aff'd per curiam* Fisher v. Commissioner, 74 F. (2d) 1014 (C. C. A. 2nd, 1935); Thomas M. McIntyre, 37 B. T. A. 812 (1938); Frank J. Lorenz, 3 T. C. 746 (1944) *Aff'd per curiam* Lorenz v. Commissioner, 148 F. (2d) 527 (C. C. A. 6th, 1945); Carl P. Munter et al., 5 T. C. , No. 6 (1945); George M. Henderson Est., B. T. A. Memo. Op., Dkt. 105615 (Dec. 13, 1941).

⁸⁷ Harry C. Fisher, 29 B. T. A. 1041 (1934) *Aff'd per curiam* Fisher v. Commissioner, 74 F. (2d) 1014 (C. C. A. 2nd, 1935); Thomas M. McIntyre, 37 B. T. A. 812 (1938); Ernest R. J. Waldburger, B. T. A. Memo.

cardinal rule that the mere fact that the taxpayer and his wife have entered into a formal agreement of partnership is not of itself sufficient to entitle them to divide for tax purposes what would otherwise be the taxpayer's income.⁸⁸ Moreover, it is entirely possible that a written agreement between the members of a family may of itself disprove the existence of a partnership. In at least one case, the Board has refused to look beyond a written agreement where its terms were in conflict with the claim that a family partnership had been created, even though the taxpayer contended that he had produced other facts which proved the existence of the status.⁸⁹

If a written partnership agreement is considered to be persuasive evidence that a family partnership status exists, the question remains as to whether or not the absence of such an agreement will be fatal in a given case. A considerable number of early decisions held that family partnerships existed even though there was no written agreement between the parties.⁹⁰ The principal effect of the absence of such an agreement was held to be the placing of a higher burden of proof upon the taxpayer.⁹¹ However, the majority of these cases arose before the family partnership device became a popular form of tax avoidance, and it would seem that they are of little more than academic importance today. This is explained by the fact that with the realization of the continued close scrutiny

Op., Dkt. 103444 (Sept. 30, 1941) *Aff'd per curiam* Waldburger v. Commissioner, 131 F. (2d) 598 (C. C. A. 2nd, 1942); Edward J. Miller, T. C. Memo. Op., Dkt. 3300 (March 18, 1944).

⁸⁸ Ernest R. J. Waldburger, B. T. A. Memo. Op., Dkt. 103444 (Sept. 30, 1941) *Aff'd per curiam* Waldburger v. Commissioner, 131 F. (2d) 598 (C. C. A. 2nd, 1942).

⁸⁹ George M. Henderson Est., B. T. A. Memo. Op., Dkt. 105615 (Dec. 13, 1941).

⁹⁰ Nancy J. Ryman et al., 5 B. T. A. 1288 (1927); M. L. Virden, 6 B. T. A. 1123 (1927); Thomas F. Kelley, 9 B. T. A. 834 (1927); Elihu Clement Wilson, 11 B. T. A. 963 (1928); H. T. Loper, 12 B. T. A. 164 (1928); R. C. McKnight, 13 B. T. A. 885 (1928); B. M. Phelps, 13 B. T. A. 1248 (1928); John Peters, 16 B. T. A. 895 (1929); John T. Newell, 17 B. T. A. 93 (1929); W. H. Simmons, 22 B. T. A. 1106 (1931); Leonard M. Gunderson, 23 B. T. A. 45 (1931); J. Kammerdiner, 25 B. T. A. 495 (1932); Charles Tift, 25 B. T. A. 986 (1932) (Although no technical partnership status recognized under Massachusetts law); Walter W. Moyer, 35 B. T. A. 1155 (1937).

⁹¹ Max Roth, 7 B. T. A. 628 (1927) (Partnership not recognized); J. W. Brackman, 24 B. T. A. 259 (1931) (Burden of proof met).

which will be given to all family partnerships, parties will in all probability reduce their understandings to writing in the hope that the partnership will be given a better chance of recognition for tax purposes.

The rule which requires the taxpayer to show the existence of a family partnership status by a preponderance of evidence is supplemented by the corollary that the mere showing of an intent to form a partnership will not carry the burden of proof.⁹² This is true even although a declaration of such intention is filed with a State official.⁹³ If the facts establish that the taxpayer had no intention of relinquishing his control over any part of the family business by an agreement which purportedly formed a partnership, the firm will not be recognized.⁹⁴ The Tax Court has held that the intention to give family members a share in a business conditioned upon their continued interest and enthusiasm in the affairs of the concern is not sufficient to prove the existence of a family partnership.⁹⁵ While testimony proving the intention of a party to form a family partnership may have some weight in proving that the intent was actually acted upon, it is necessary to show by the conduct of the parties that the intention to form the partnership was consummated by actual organization.

Documentary evidence is not the only type of proof which can be drawn upon to show that the parties intended to create a partnership status. For instance, the desire of an individual to lessen his participation in business and to bring in a member of his family to carry part of the burden is evidence that a bona fide partnership was

⁹² James H. Persons, 5 B. T. A. 716 (1926); John W. Graham, 8 B. T. A. 1081 (1927) (No intention proved); William D. Hutchins, 14 B. T. A. 421 (1928); James L. Robertson, 20 B. T. A. 112 (1930); Ed Kasch et al., 25 B. T. A. 284 (1932) *Aff'd* Kasch v. Commissioner, 63 F. (2d) 466 (C. C. A. 5th, 1933) *Cert. denied* 290 U. S. 644 (1933); Joseph Supornick, T. C. Memo. Op., Dkt. 356 (Nov. 13, 1943) *Aff'd* Supornick v. Commissioner, 150 F. (2d) 110 (C. C. A. 8th, 1945).

⁹³ W. A. Felton, 18 B. T. A. 63 (1929).

⁹⁴ Ed Kasch et al., 25 B. T. A. 284 (1932) *Aff'd* Kasch v. Commissioner, 63 F. (2d) 466 (C. C. A. 5th, 1933) *Cert. denied* 290 U. S. 644 (1933).

⁹⁵ Joseph Supornick, T. C. Memo. Op., Dkt. 356 (Nov. 13, 1943) *Aff'd* Supornick v. Commissioner, 150 F. (2d) 110 (C. C. A. 8th, 1945).

created.⁹⁶ Moreover, proof that each member of the family had a thorough understanding of the business will be helpful in establishing the validity of the firm for tax purposes.⁹⁷ Of equal importance, in those cases involving more than one family, is the acceptance by the non-family members of the new partner, and the recognition of his status as a member of the partnership.⁹⁸

Certain types of evidence extrinsic to the partnership itself are of utmost importance in proving the valid exist-

⁹⁶ W. A. Billingsrath, 3 B. T. A. 11 (1925); Frank E. Eyestone, 12 B. T. A. 1232 (1928); Charles W. Crane, 19 B. T. A. 577 (1930); J. D. Johnston, Jr., 3 T. C. 799 (1944); M. W. Turner et al., T. C. Memo. Op., Dkts. 2460, 2461 (Nov. 30, 1944). However, the mere fact that the taxpayer has become partially disabled and wishes to give his wife an interest in his business will not of itself prove the existence of a family partnership. There must, in addition, be acts and conduct to show that the desire was carried out and that a partnership was actually formed. Julius Goldenberg, 5 B. T. A. 213 (1926). See also Irwin J. Miller, T. C. Memo. Op., Dkt. 2272 (Oct. 9, 1944) *Aff'd per curiam* Miller v. Commissioner, 150 F. (2d) 823 (C. C. A. 2nd, 1945), in which the taxpayer assigned his interest in a partnership which was composed of the taxpayer and his father, to his wife, who was in poor health. After the assignment, the wife contributed no services to the firm, had no drawing account, and used the firm profits which were given to her to defray household expenses. The Tax Court held that no valid partnership had been created. Conflicting results have been reached where the family member has been made a partner for other business reasons. Thus, in Benjamin Shander, T. C. Memo. Op., Dkt. 111788 (March 11, 1943), a family partnership was formed primarily because a bank refused to lend money to the business which, up to that time, had been conducted as a sole proprietorship. The ground for the bank's refusal was the age of the sole proprietor, and it was insisted that a partnership be formed which would include the taxpayer's sons. The partnership status was recognized. However, in E. C. Ellery, 4 T. C. 407 (1944), a partnership was not recognized where the taxpayer made his wife a partner in order that the wife, who had been employed in the business, could deal more freely with customers of the firm. The decision seemingly rests upon the ground that the gift of the firm interest was invalid, since it was conditioned upon the formation of a partnership whose business would have been illegal under state law.

⁹⁷ Sidney M. Harvey, B. T. A. Memo. Op., Dkt. 109298 (Oct. 14, 1942); Sidney M. Harvey, T. C. Memo. Op., Dkt. 1056 (Sept. 27, 1944); M. W. Turner et al., T. C. Memo. Op., Dkts. 2460, 2461 (Nov. 30, 1944). The fact that the family member who is made a member of a family partnership knows nothing of the business activities of the firm is evidence pointing to the result that the parties have merely attempted to reallocate income within the family unit. Joseph W. Grant et al., T. C. Memo. Op., Dkts. 407, 416 (Aug. 3, 1944) *Aff'd* Grant v. Commissioner, 150 F. (2d) 915 (C. C. A. 10th, 1945).

⁹⁸ Rose v. Commissioner, 65 F. (2d) 616 (C. C. A. 6th, 1933); W. A. Billingsrath, 3 B. T. A. 11 (1925); Harry P. Kelley, 9 B. T. A. 832 (1927); J. E. Biggs, Sr., 15 B. T. A. 1092 (1929); Charles W. Crane, 19 B. T. A. 577 (1930); Jasper Sipes, 31 B. T. A. 709 (1934). Where the non-family partner does not know of the presence of the new partner, or refuses to accept him as such, the partnership status will not be recognized. Houston Brothers, 22 B. T. A. 51 (1931); George W. Balkwill, 25 B. T. A. 1147 (1932) *Aff'd* Balkwill v. Commissioner, 77 F. (2d) 569 (C. C. A. 6th, 1935) *Cert. denied* 296 U. S. 609 (1935).

ence of the firm. By all odds, the most persuasive evidence of this character is a showing that the enterprise was known to be conducted as a partnership by those who dealt with it in a business way. With but few exceptions,⁹⁹ the cases have uniformly held that knowledge on the part of banks, customers, salesmen and the trade in general that members of a family were conducting their business as a partnership will be given substantial weight in determining the valid existence of the firm.¹⁰⁰ The same is true with respect to similar knowledge on the part of business associates¹⁰¹ and credit rating institutions.¹⁰² The fact that a contract entered into by the partnership with third persons and the bond which secured it had been signed by all the members of the family as principals has been held to be evidence tending to prove that a family partnership has been organized.¹⁰³ A similar effect has been given to a general reputation in the community that the family business was being conducted as a partnership.¹⁰⁴ However, where the taxpayer has made statements to third parties for non-business reasons to the effect that his business was being conducted by a family partnership, the knowledge of such persons is of little or no value to prove the valid existence of the firm.¹⁰⁵ Moreover, if the taxpayer is unable to show that any third person knew of the existence of the firm, his chances for a decision which would recognize its existence for tax purposes are negligible.¹⁰⁶ Related to this type of proof is evidence showing that the interest of a family member in a partnership is

⁹⁹ R. A. Bartley, 4 B. T. A. 874 (1926); James O. Peterson, T. C. Memo. Op., Dkt. 251 (Nov. 30, 1943).

¹⁰⁰ H. T. Loper, 12 B. T. A. 164 (1928); John T. Newell, 17 B. T. A. 93 (1929); W. H. Simmons, 22 B. T. A. 1106 (1931); Albert G. Dickinson, 23 B. T. A. 1212 (1931); J. W. Brackman, 24 B. T. A. 259 (1931); Richard H. Oakley, 24 B. T. A. 1082 (1931); J. Kammerdiner, 25 B. T. A. 495 (1932).

¹⁰¹ Nancy J. Ryman, et al., 5 B. T. A. 1288 (1927); Leonard M. Gunderson, 23 B. T. A. 45 (1931).

¹⁰² M. L. Virden, 6 B. T. A. 1123 (1927). *But see* M. A. Long, 8 B. T. A. 737 (1927), where notice to the same institution was deemed insufficient.

¹⁰³ *Montgomery v. Thomas*, 146 F. (2d) 76 (C. C. A. 5th, 1944).

¹⁰⁴ R. C. McKnight, 13 B. T. A. 885 (1928).

¹⁰⁵ James L. Robertson, 20 B. T. A. 112 (1930).

¹⁰⁶ Julius Goldenberg, 5 B. T. A. 213 (1926); W. A. Felton, 18 B. T. A. 63 (1929); Thomas M. McIntyre, 37 B. T. A. 812 (1938); Joseph W. Grant et al., T. C. Memo. Op., Dkts. 407, 416 (Aug. 3, 1944) *Aff'd* Grant v. Commissioner, 150 F. (2d) 915 (C. C. A. 10th, 1945).

recognized after a dissolution of the firm. Thus a showing that the family business was incorporated and that each member of the family received stock in proportion to his former interest in the firm is helpful in proving that a bona fide family partnership had been created.¹⁰⁷

Although not considered determinative as a matter of law,¹⁰⁸ decisions of state courts to the effect that members of a family were conducting business on a partnership basis are given some consideration as evidence tending to prove the existence of the firm for tax purposes.¹⁰⁹ Local state statutes raising presumptions in favor of the existence of partnerships have also been given some weight in tax cases.¹¹⁰ It would seem to be the better view, however, that such statutes together with statements filed with state officials which designate a business as a partnership are of no value as proof that the firm was substantive in character, and this type of evidence should be ignored by the courts.¹¹¹

In the trial of a case, the weight to be accorded any evidence is conditioned to some extent upon the personality of the witness who introduces it. Family partnership cases are no exception. The Board, in several cases, has stated that the uncorroborated and self-serving statements of a taxpayer made at the hearing to the effect that his business was carried on as a family partnership were not sufficient to prove the valid existence of the firm.¹¹² The same rule has been reiterated by the Tax Court.¹¹³

¹⁰⁷ Justin Potter, 47 B. T. A. 607 (1942).

¹⁰⁸ See *infra*, pp. 207 to 211 for a full discussion of this point.

¹⁰⁹ Irene McCullough et al., T. C. Memo. Op., Dkts. 1710, 1711 (July 19, 1944); George A. Croft, T. C. Memo. Op., Dkt. 1432 (Oct. 11, 1944).

¹¹⁰ Elihu Clement Wilson, 11 B. T. A. 963 (1928); W. H. Simmons, 22 B. T. A. 1106 (1931).

¹¹¹ Local statutes raising presumptions that a partnership exists are, for the most part, intended to protect creditors of the firm, and hence have no bearing on their tax status. Declarations filed with state officials under "Fictitious Name" statutes are, in reality, no more than the taxpayer's own statements that a family partnership exists, and are of no importance for the purposes of the income tax law. See James O. Peterson, T. C. Memo. Op., Dkt. 251 (Nov. 30, 1943).

¹¹² W. A. Felton, 18 B. T. A. 63 (1929); James L. Robertson, 20 B. T. A. 112 (1930); W. M. Buchanan, 20 B. T. A. 210 (1930); Cf. Charles G. Black, 39 B. T. A. 1068, 1071 (1939) *Rev'd* Black v. Commissioner, 114 F. (2d) 355 (C. C. A. 9th, 1940).

¹¹³ Stanley Bradshaw, T. C. Memo. Op., Dkt. 334 (July 31, 1944) *Aff'd* Bradshaw v. Commissioner, 150 F. (2d) 918 (C. C. A. 10th, 1945).

It is uncertain at the present time whether or not the uncorroborated testimony of a taxpayer's wife or child or a member of his family carries a similar disability. In at least one case, the Tax Court, two judges dissenting, sustained the existence of a family partnership for tax purposes, even though the major part of the evidence had been supplied by the taxpayer's wife.¹¹⁴

A number of cases have contained statements to the effect that a family partnership will be disregarded if it appears from the evidence that the parties intended to avoid taxes by means of the organization of the firm.¹¹⁵ A possible inference from such statements is that the intention of the parties is an important factor in the determination of whether or not a partnership will be recognized for tax purposes.¹¹⁶ Actually, this is not the case. The reason for this lies in the fact that the tests which must be met before a firm will be disregarded taxwise are based upon what the parties have done, as distinguished from what they believe they have accomplished. The decisions have inferred, for instance, that even though the testimony of a taxpayer to the effect that he had no intention of avoiding taxes in creating his partnership is

¹¹⁴Felix Zukaitis, 3 T. C. 814 (1944).

¹¹⁵*Tinkoff v. Commissioner*, 120 F. (2d) 564 (C. C. A. 7th, 1941) *Cert. denied* 314 U. S. 581 (1941); *A. R. Losh*, 1 T. C. 1019 (1943) *Aff'd Losh et al. v. Commissioner*, 145 F. (2d) 456 (C. C. A. 10th, 1944); *Francis Doll*, 2 T. C. 276 (1943) *Aff'd Doll v. Commissioner*, 149 F. (2d) 239 (C. C. A. 8th, 1945) *Cert. applied* June 19, 1945; *A. L. Lusthaus*, 3 T. C. 540 (1944) *Aff'd Lusthaus v. Commissioner*, 149 F. (2d) 232 (C. C. A. 3rd, 1945); *O. William Lowry*, 3 T. C. 730 (1944) On appeal, Circuit Court, Sixth Circuit; *M. M. Argo*, 3 T. C. 1120 (1944) *Aff'd on other grounds Argo v. Commissioner*, 150 F. (2d) 67 (C. C. A. 5th, 1945); *B. A. Schroder*, B. T. A. Memo. Op., Dkt. 108729 (June 23, 1942) *Aff'd Schroder v. Commissioner*, 134 F. (2d) 346 (C. C. A. 5th, 1943).

¹¹⁶Seizing upon this inference, taxpayers have attempted to have their partnerships recognized for tax purposes by introducing evidence that the parties had no intention to avoid taxes when the firm was organized. *Lewis H. Singletary*, 5 T. C. , No. 42. Proof of intention may be made in two principal ways. The first is by means of introducing the testimony of the taxpayer with respect to his motives. However, since such testimony has been given little if any probative weight in determining other facts in partnership cases, *supra* n. 112, it is not surprising to find that it is regarded as of no value in proving intention. The second method of proving intention is by showing conduct which relates to it. But proof of such conduct will also establish the facts which must be present before a family partnership will be recognized for tax purposes. It follows, therefore, that while proof of conduct may in a given case prove intention, it will also establish the validity of the firm, and as a result intention, as such, becomes unimportant.

admitted to be true, the firm will be disregarded if there is insufficient evidence of conduct to comply with the accepted requirements.¹¹⁷ It follows, therefore, that the conduct of the parties is the controlling factor in each case. Moreover, there should be no particular quarrel with this result, in view of the fact that the question of intention is at best an extremely difficult element of proof, and because experience has shown that results have been far from satisfactory in other fields of tax law in which the criterion of liability has depended upon the intention of the taxpayer.¹¹⁸

A family partnership which derives the major part of its income from the use of capital¹¹⁹ will not be recog-

¹¹⁷ A recent dictum by the Tax Court in *Lewis H. Singletary*, 5 T. C. , No. 42, indicates that motive is neutral. In that case, the taxpayer had given an interest in his gasoline business to his wife, and at a later date had given an interest in the same business to his mother and father. Both the taxpayer and his wife testified that tax saving had not animated him, or them, in the making of the gifts. The Court, holding the taxpayer had failed to show that the income from the business did not belong *in toto* to him, disregarded the partnership. The opinion is confusing. It seemingly relies both upon the fact that the business was largely personal in its nature, making the ownership of capital unimportant, and upon the fact that no assets were in reality given or sold by the taxpayer to members of his family. However, the ultimate result reached in the case, namely, that the taxpayer had failed to meet the burden of proof cast upon him by the Commissioner's determination, seems sound.

¹¹⁸ The most flagrant example is, of course, the requirement of Int. Rev. Code §811 (c) for the inclusion in the gross estate of any interest in property which a decedent has transferred in contemplation of death. It has been suggested that although this section has been in effect for almost thirty years, and has been considered by a great number of cases, its meaning is still so unsettled as to produce contrary results in almost identical fact patterns. Pavenstedt, *Taxation of Transfers in Contemplation of Death: A Proposal for Abolition* (1944), 54 Yale L. J. 70. One of the principal obstacles in this section, and the Regulations which have attempted to construe it, is that tax liability has been made to turn on motives which caused certain operative acts to occur, rather than on the occurrence of the acts themselves.

¹¹⁹ The fact that capital is an important element in the production of income must be proved. As stated at another point in this paper, several methods of approach may be used in this respect, but it should be remembered that in each of them the taxpayer has the burden of proof. For instance, if it appeared that an individual was earning certain commissions on the sale of products without owning any of the equipment needed in making deliveries, and if it further appeared that he subsequently purchased such equipment and formed a family partnership, the burden would fall upon the taxpayer to show the importance of the new capital to the business. The Tax Court has held, in such a case, that the receipt by a partnership of substantially the same amount of profits as was received by the individual at a time when he was admittedly conducting a personal service business would tend to prove that capital was unimportant. *D. H. McEachern*, 5 T. C. , No. 4 (1945).

nized unless it can be shown that each partner contributed services or capital owned by him to the firm. In such cases, where the existence of the firm is rested solely upon the contention that capital has been contributed by a member of the family, the amount of property supplied by a member of the family must be shown with some degree of accuracy; and it must also be proved that the assets were contributed as a partner.¹²⁰ Moreover, an indispensable element of proof in such cases is that the capital was the property of the contributor and not that of another member of the same family group. Proof of the ownership of such assets may be drawn from a variety of sources. For instance, book entries which are not fictitious¹²¹ and which clearly reflect the interest of a family member as a member of the family partnership are given some weight.¹²² On the other hand, the mere showing that the name of the wife or son of a taxpayer appears on the firm books as a partner will not, standing alone, be sufficient to establish the independent ownership of part of the firm assets by such persons.¹²³ However, the absence of book entries is not fatal. In several cases, the Board has clearly

¹²⁰ *Penziner v. United States*, 54 F. Supp. 842 (N. D. Calif., 1944).

¹²¹ In *Blalock v. Allen*, 56 F. Supp. 266 (M. D. Ga., 1944), the Court refused to recognize a partnership in which an interest had been sold to the taxpayer's aged father. Although the shares owned by each partner were clearly reflected on the books of the firm, the entries were regarded as fictitious and were therefore given no weight.

¹²² For cases in which no book entries could be produced showing the interest of the members of the family other than the taxpayer and where the partnership was accordingly not recognized for tax purposes, see: *Julius Goldenberg*, 5 B. T. A. 213 (1926); *Hudson M. Knapp*, 5 B. T. A. 762 (1926). In *Dawes v. Allen*, F. Supp. (M. D. Ga., 1945) the Court relied on book entries which showed that the taxpayer was the sole owner of the assets of a business in refusing to recognize a family partnership even though the taxpayer's father had made advances to firm capital. In the following cases, book entries were held to be persuasive evidence of ownership by members of a family of assets employed by a family partnership: *M. L. Virden*, 6 B. T. A. 1123 (1927); *Walter W. Moyer*, 35 B. T. A. 1155 (1937); *J. D. Johnston, Jr.*, 3 T. C. 799 (1944); *R. C. Bennett*, B. T. A. Memo. Op., Dkt. 101715 (Sept. 2, 1941). See also *Arthur Stryker*, 17 B. T. A. 1033 (1929); *Albert G. Dickinson*, 23 B. T. A. 1212 (1931), where no technical partnership was found to exist due to the fact that under state law such relationships were not recognized between husband and wife. However, book entries were relied upon to show that income was derived from capital which was separately owned by the wife, and this income was accordingly held to be not taxable to the husband.

¹²³ *Ed Kasch et al.*, 25 B. T. A. 284 (1932) *Aff'd* *Kasch v. Commissioner*, 63 F. (2d) 466 (C. C. A. 5th, 1933) *Cert. denied* 290 U. S. 644 (1933); *S. M. 4277*, IV—2 CUM. BULL. 58 (1925).

stated that the absence of accounts in the name of a family member is merely evidentiary, and has sustained the partnership for tax purposes even though the taxpayer was unable to show that the family member was recognized as a member of the firm on its books.¹²⁴

Connected with the weight to be given to book entries in family partnership cases is the evidentiary emphasis to be placed on the right of all partners to require that their distributive share of firm income be paid to them at established intervals. While not absolutely essential to the validity of a family partnership,¹²⁵ the presence in the firm agreement of the right of each partner to withdraw his share of firm profits as he chooses is taken as strong indication that he owned part of the firm assets. In numerous cases, the Board and Tax Court have emphasized the presence of a right of withdrawal as one of the elements which tend to sustain a family partnership for tax purposes.¹²⁶ The right to draw checks in the name of the firm similarly has been accorded some weight.¹²⁷ Conversely, the absence of withdrawal privileges or the retention of an unfettered power to withdraw firm profits by the head of the family has been held to be strong indication that no independent capital had been contributed by each member of a family, and, as a result, that no family partnership had been created.¹²⁸ In this connection,

¹²⁴ E. L. Kier, 15 B. T. A. 1114 (1929); John T. Newell, 17 B. T. A. 93 (1929); Leonard M. Gunderson, 23 B. T. A. 45 (1931). *Cf.* Charles Tift, 25 B. T. A. 986 (1932) (No technical partnership recognized under Massachusetts law).

¹²⁵ Millard D. Olds, 15 B. T. A. 560 (1929) *Aff'd* Commissioner v. Olds, 60 F. (2d) 252 (C. C. A. 6th, 1932); E. L. Kier, 15 B. T. A. 1114 (1929); Irene McCullough et al., T. C. Memo. Op., Dkts. 1710, 1711 (July 19, 1944).

¹²⁶ R. A. Bartley, 4 B. T. A. 874 (1926); Nancy J. Ryman et al., 5 B. T. A. 1288 (1927); J. D. Johnston, Jr., 3 T. C. 799 (1944); M. W. Smith, 3 T. C. 894 (1944).

¹²⁷ J. D. Johnston, Jr., 3 T. C. 799 (1944); Davis B. Thornton, 5 T. C. , No. 13 (1945). In *Hodgson v. Willingham*, F. Supp. (M. D. Ala., 1945), the absence of this power was considered important in determining that a wife was not the business partner of her husband. *See also* Blalock v. Allen, 56 F. Supp. 266 (M. D. Ga., 1944).

¹²⁸ Harry C. Fisher, 29 B. T. A. 1041 (1934) *Aff'd per curiam* Fisher v. Commissioner, 74 F. (2d) 1014 (C. C. A. 2nd, 1935); Frank J. Lorenz, 3 T. C. 746 (1944) *Aff'd per curiam* Lorenz v. Commissioner, 148 F. (2d) 527 (C. C. A. 6th, 1945); A. M. Mead, B. T. A. Memo. Op., Dkt. 108837 (April 2, 1942); B. A. Schroder, B. T. A. Memo. Op., Dkt. 108729 (June 23, 1942) *Aff'd* Schroder v. Commissioner, 134 F. (2d) 346 (C. C. A. 5th, 1943); Stanley Bradshaw, T. C. Memo. Op., Dkt. 334 (July 31, 1944) *Aff'd* Bradshaw v. Commissioner, 150 F. (2d) 918 (C. C. A. 10th, 1945).

the Tax Court¹²⁹ has emphasized the fact that a provision in a partnership agreement giving a husband the sole power of withdrawal coupled with a provision that one-half of his withdrawals would be charged against his wife's capital account, was sufficient evidence to justify the disregard of the partnership for tax purposes.¹³⁰

Effect of Local Law.

The impact of local law on family partnership cases has been felt in two principal ways. In the first place, the decisions have, at times, pointed to local requirements existing under state law in demonstrating that a family partnership did or did not exist for tax purposes. In the second place, some attention has been given, in recent cases, to the fact that taxpayers have obtained declaratory judgments from state courts to the effect that they were conducting their business in partnership form. Neither the fact that the members of a family have complied with all requirements of local law, nor the existence of a local court decree declaring the status between the parties to be a partnership, should have any substantive bearing, however, on the question of whether or not the firm will be recognized for tax purposes.¹³¹

Before the family partnership device became a popular method of splitting surtaxes, the Board was content to determine whether or not a firm had been created by matching the activities of the parties with the requirements of the

¹²⁹ Frank J. Lorenz, 3 T. C. 746 (1944) *Aff'd per curiam* Lorenz v. Commissioner, 148 F. (2d) 527 (C. C. A. 6th, 1945).

¹³⁰ Actually, the Tax Court was content to place its decision on the ground that the taxpayer had made no gift to his wife of the assets which were purportedly contributed by her to the firm. Since the wife contributed no services to the partnership, her status as a partner depended on an ownership of firm assets. The Tax Court emphasized the fact that the failure on the part of the taxpayer to relinquish dominion and control over the subject matter of the purported gift by means of the provision relating to drawing accounts indicated that no gift had been made.

¹³¹ As pointed out, *supra*, n. 109, a decree which declares that the status existing between members of a family is a partnership has been given some evidentiary weight in tax cases. The following discussion, however, deals with the question of whether or not such decrees, or the meeting of local law requirements, are binding as a matter of substantive law on the issue of the recognition of family partnerships for tax purposes.

law of the state in which they lived.¹³² In this respect, emphasis was placed upon state statutes which presumed the existence of a partnership from the fact that a party received a share of profits from a business,¹³³ and upon state code provisions which did not make the contribution of capital a necessary factor in the creation of a firm.¹³⁴ Using the same approach, the Bureau ruled on numerous occasions that a partnership would be regarded for tax purposes if a wife could enter into a contract with her husband under provisions of the law of their domicile,¹³⁵ but held that no family partnership would be recognized if the wife was unable to form such an agreement because of the disabilities of local law.¹³⁶ Moreover, it was not uncommon at that early date for the Government to contend that a husband and wife could not be partners for income tax purposes because they were incapable of entering into such a relationship by virtue of some local law provision. However, these contentions were uniformly rejected if the Board was satisfied that a wife had an interest in the

¹³² *W. A. Bellingrath*, 3 B. T. A. 11 (1925); *H. J. Barton*, 3 B. T. A. 1262 (1926); *R. A. Bartley*, 4 B. T. A. 874 (1926); *R. C. McKnight*, 13 B. T. A. 885 (1928); *E. L. Kier*, 15 B. T. A. 1114 (1929); *J. Kammerdiner*, 25 B. T. A. 495 (1932).

¹³³ *W. H. Simmons*, 22 B. T. A. 1106 (1931). The Board rested its decision on the presumption created by a provision of the Tennessee Code, and on the ground that members of the family contributed some services to the business, which required little if any capital.

¹³⁴ *Elihu Clement Wilson*, 11 B. T. A. 963 (1928). This case should not be followed today, principally because it was clearly proved that the wives of the taxpayers contributed neither services nor capital to the partnership. The Board, in sustaining the firm for tax purposes, took the position that it was unnecessary to show such contributions under the statutes relating to partnerships in California. The rule should be, however, that such statutes are not binding on the courts in tax cases, and they should be given no weight.

¹³⁵ *G. C. M. 450*, V—2 CUM. BULL. 49 (1926) (Arkansas); *I. T. 1744*, II—2 CUM. BULL. 179 (1923) (California); *S. M. 2963*, IV—1 CUM. BULL. 171 (1929) (Colorado); *G. C. M. 433*, V—2 CUM. BULL. 177 (1926) (Connecticut); *G. C. M. 3421*, VII—1 CUM. BULL. 106 (1928) (District of Columbia); *G. C. M. 2448*, VI—2 CUM. BULL. 69 (1927) (Florida, if the wife had become a "free dealer"); *S. M. 5042*, V—1 CUM. BULL. 68 (1926) (Georgia); *I. T. 2321*, V—2 CUM. BULL. 52 (1926) (Iowa); *I. T. 2240*, IV—2 CUM. BULL. 60 (1925) (Kansas); *S. M. 4277*, IV—2 CUM. BULL. 58 (1925) (Minnesota, but firm not recognized because of lack of evidence); *S. R. 6998*, V—1 CUM. BULL. 268 (1926) (Nebraska); *G. C. M. 5761*, VIII—1 CUM. BULL. 109 (1929) (New York); *G. C. M. 3034*, VII—1 CUM. BULL. 104 (1923) (North Carolina); *S. M. 3391*, IV—1 CUM. BULL. 42 (1925) (South Carolina).

¹³⁶ *I. T. 1371*, I—1 CUM. BULL. 208 (1922) (Maine); *S. R. 7199*, V—1 CUM. BULL. 269 (1926) (Michigan); *S. R. 2863*, IV—1 CUM. BULL. 174 (1925) (Texas); *S. M. 3917*, IV—2 CUM. BULL. 189 (1925) (Vermont).

capital employed in her husband's business, the decisions resting chiefly upon the ground that the income derived from such capital was not owned by the husband.¹³⁷

Although there is some authority to the contrary,¹³⁸ the rule undoubtedly should be to the effect that provisions of local law have no bearing on the question of the existence of a family partnership for tax purposes.¹³⁹ The reason for this lies in the simple and often-repeated principle

¹³⁷ These contentions were advanced with respect to taxpayers who lived in Michigan. The Board has held that while husband and wife could not be partners under the common law of that state, they could be considered members of a joint venture for tax purposes. *L. F. Sunlin*, 6 B. T. A. 1232 (1927). Other cases involving residents of Michigan have refused to tax a husband on income which was produced by capital owned by his wife, even though that capital formed part of the assets of a family business. *Earle L. Crossman*, 10 B. T. A. 248 (1928); *Elmer Klise*, 10 B. T. A. 1234 (1928); *Albert Kahn*, 14 B. T. A. 125 (1928); *R. E. Wing*, 17 B. T. A. 1028 (1929); *Alfred T. Wagner*, 17 B. T. A. 1030 (1929); *Albert G. Dickinson*, 23 B. T. A. 1212 (1931); *James O. Peterson*, T. C. Memo. Op., Dkt. 251 (Nov. 30, 1943). Cases have also characterized residents of Michigan as partners for tax purposes. *Felix Zukaitis*, 3 T. C. 814 (1944). It was not necessary, however, for a party living in Michigan to own part of the partnership assets before he was considered a member of the firm. Contribution of services has been held to be sufficient. *James N. Purse*, 27 B. T. A. 725 (1933). The rule which obtains for residents of Michigan has been applied where the parties live in Massachusetts. *Warren MacPherson*, 19 B. T. A. 651 (1930); *Charles Tift*, 25 B. T. A. 986 (1932). The same result has been reached with respect to residents of New Jersey. *Arthur Stryker*, 17 B. T. A. 1033 (1929). Although a husband and wife could not enter into a legal partnership in West Virginia, the fact that their respective rights could be enforced in equity has been relied upon to sustain a family partnership for tax purposes. *J. E. Biggs, Sr.*, 15 B. T. A. 1092 (1929); *J. W. Brackman*, 24 B. T. A. 259 (1931); *Pugh v. United States*, 48 F. (2d) 600 (S. D. W. Va., 1931).

¹³⁸ In *Champlin v. Commissioner*, 71 F. (2d) 23 (C. C. A. 10th, 1934), the Court, in reversing the Board's determination that no partnership status existed between a husband and wife, held that the relationship between the parties was to be determined by the laws of Oklahoma, and that under that law the parties had formed a "mining partnership" which should be recognized for tax purposes. *Commissioner v. Tenney*, 120 F. (2d) 421 (C. C. A. 1st, 1941) contains strong dictum to the effect that provisions of local law should control. There the wife agreed with her husband to supply capital if he would contribute services to a stock market trading venture. The parties further agreed to divide equally the net profits and losses of the enterprise. The Court, apparently assuming that the parties intended to form a partnership, stated that the insurmountable difficulty was that in Massachusetts a married woman was incapable of making a contract of partnership with her husband. The partnership was disregarded. To the extent that these cases stand for the proposition that local law provisions should control the question of whether or not a partnership exists for tax purposes, it is believed that they are bad law. See also *E. C. Ellery*, 4 T. C. 407, (1944), which relies on the illegality of the partnership business as grounds for its disregard.

¹³⁹ *M. M. Argo*, 3 T. C. 1120 (1944) *Aff'd on other grounds* *Argo v. Commissioner*, 150 F. (2d) 67 (C. C. A. 5th, 1945).

that Federal taxes are meant to be uniform throughout the country, and that it is only where Congress has selected some provision of local law to control the incidence of taxation that such provisions should be given any weight. As pointed out above, Congress, instead of defining a partnership in terms of local law, has left the problem of characterization for the most part in the hands of the courts. It can hardly be questioned, therefore, that it was intended that a uniform definition of a partnership should apply for tax purposes, no matter where the taxpayer lives or what the local law requirements of his home state may be. Moreover, it takes no imagination to see that hopeless chaos instead of uniformity would result if the varying provisions of local law were relied upon to determine whether or not a family partnership should be regarded for the purposes of the income tax law.¹⁴⁰

If compliance by the parties with local law requirements relating to partnerships has no bearing on the question of the existence of a family partnership, it should follow that a decree passed by a state court which in effect declares that those requirements have been met by a husband and wife is of no importance. The cases have been consistent in stating that such decrees are not binding whether the partnership was¹⁴¹ or was not recognized for tax purposes.¹⁴² This result has been reached even though the Commissioner was made a party to the suit seeking

¹⁴⁰ This is clearly illustrated by the rulings of the Bureau. In S. M. 2373, III—2 CUM. BULL. 169 (1924) it was held that under the law of South Carolina a married woman had no power to enter into a contract of partnership with her husband, and that as a result she could not enter into such a partnership for income tax purposes. Subsequently, the Supreme Court of South Carolina held that a partnership between husband and wife was permitted under Section 3761 of the South Carolina Code. Faced with what appeared to be a change in local law, the Bureau held that its former ruling should be disregarded. S. M. 3391 IV—1 CUM. BULL. 42 (1925). Carrying this approach to its logical conclusion, it would follow that every change in local law on the question of the power of a husband and wife to enter into a partnership agreement would require a corresponding change for Federal tax purposes.

¹⁴¹ In both *Millard D. Olds*, 15 B. T. A. 560 (1929) *Aff'd* Commissioner v. Olds, 60 F. (2d) 252 (C. C. A. 6th, 1932) and *George A. Croft*, T. C. Memo. Op., Dkt. 1432 (Oct. 11, 1944), a suit was brought in the state court which sought a declaratory decree after the taxpayer had received his deficiency notice.

¹⁴² *Doll v. Commissioner*, 149 F. (2d) 239 (C. C. A. 8th, 1945) *Cert. Applied*, June 19, 1945; *Frank J. Lorenz*, 3 T. C. 746 (1944) *Aff'd per curiam* *Lorenz v. Commissioner*, 148 F. (2d) 527 (C. C. A. 6th, 1945).

the declaratory decree,¹⁴³ and in those cases in which the declaratory decree was sought before the Government's claim for additional taxes was made known to the taxpayer.¹⁴⁴ Moreover, in cases in which the declaratory decree was sought after the taxpayer was aware of the Government's position with respect to a family partnership, it is not unusual to find such proceeding branded as "collusive",¹⁴⁵ and in all probability the taxpayer was the worse off for having initiated such litigation.

The Effect of the Clifford and Stuart Cases.

Any opinion by the Supreme Court bearing upon the tax consequences of an attempted reallocation of income within a family group¹⁴⁶ would in theory cut across the question of to whom income from a family partnership should be taxed. It is not surprising to find, therefore, that the most important recent decision in this field, *Helvering v. Clifford*,¹⁴⁷ has played its part as a touchstone in many of the cases which have considered the family partnership problem. The often told story of the *Clifford* case will not be repeated here.¹⁴⁸ It is sufficient to say

¹⁴³ *Wilson v. Wilson*, 141 F. (2d) 599 (C. C. A. 4th, 1944).

¹⁴⁴ *Justin Potter*, 47 B. T. A. 607 (1942).

¹⁴⁵ *Francis Doll*, 2 T. C. 276 (1943) *Aff'd* *Doll v. Commissioner*, 149 F. (2d) 239 (C. C. A. 8th, 1945) *Cert. Applied*, June 19, 1945.

¹⁴⁶ An early and perhaps the best known of these cases is, of course, *Lucas v. Earl*, 281 U. S. 111. The doctrine there set forth, namely "that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew" has foraged far afield to cut down tax saving arrangements within a family. Consider, for example, the recent decision in *Commissioner v. Harmon*, 323 U. S. 44 (1944). *See also*: *Helvering v. Horst*, 311 U. S. 112 (1940); *Helvering v. Eubank*, 311 U. S. 122 (1940); *Harrison v. Schaffner*, 312 U. S. 579 (1941). It should be borne in mind, however, that these cases deal with the assignment of income and not with the assignment of income-producing property.

¹⁴⁷ 309 U. S. 331 (1940).

¹⁴⁸ *Magill, What Shall Be Done with the Clifford Case?* (1945) 45 Col. L. Rev. 111; *Case, The Circuit Courts of Appeals Examine the Clifford Doctrine* (1943) 7 Md. L. Rev. 201; *Merrills, Status of Short Term Trusts* (1943) 28 Wash. U. L. Q. 99; *Pavenstedt, The Broadened Scope of Section 22 (a): The Evolution of the Clifford Doctrine* (1941) 51 Yale L. J. 213; *Griswold, A Plan for the Coordination of the Income, Estate and Gift Tax Provisions with Respect to Trusts and Other Transfers* (1942) 56 Harv. L. Rev. 337; *Higgins, Recent Developments in the Taxation of Short-Term Irrevocable Trusts* (1942) 30 Geo. L. J. 656; *Surrey, The Supreme Court and The Federal Income Tax* (1941) 35 Ill. L. Rev. 779, 794-803; *Ray, The Income Tax on Short Term and Revocable Trusts* (1940) 53 Harv. L. Rev. 1322; *James, Family Trusts and Federal Taxes* (1942)

that the Supreme Court, in a case obviously conducive to success on the part of Government advocacy,¹⁴⁹ held that income earned by property which a settlor had placed irrevocably in trust for a period of five years, the trust instrument naming the settlor as trustee and giving him broad powers of control over the *res*, its income and its distribution, was taxable to the settlor under Section 22(a) of the Internal Revenue Code. Although the many decisions which have been handed down in the post-*Clifford* era may be subject to general classification,¹⁵⁰ and although the uncertainty which the *Clifford* case created might justify Congressional action,¹⁵¹ the important fact to be borne in mind for the purposes of the present discussion is the sweeping rationale of the general doctrine. Speaking for the Court, Mr. Justice Douglas stated, as a basis for his decision, that¹⁵²

“ . . . when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had . . . For where the head of the household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group.”

Family partnership cases present two general patterns in which an attempt has been made to use the *Clifford* doctrine for the purposes of taxing all of the income from a business to the head of the family. The first of these is the situation in which no trust device is used, but in which the head of the family, by means of the partnership entity, has attempted to split his surtax while at the same

9 U. of Chi. L. Rev. 427; Griswold, *A Summary of the Regulations Problem* (1941) 54 Harv. L. Rev. 398, 421-422; Nash, *Implications of Some Recent Developments in the Taxation of Trusts* (1940) 18 Tax Mag. 267; See also 6 MERTENS, *LAW OF FEDERAL INCOME TAXATION* (1942) §37.17, 37.18.

¹⁴⁹ Magill, *What Shall Be Done with the Clifford Case* (1945) 45 Col. L. Rev. 111, 115.

¹⁵⁰ Case, *The Circuit Courts of Appeals Examine the Clifford Doctrine* (1943) 7 Md. L. Rev. 201.

¹⁵¹ Magill, *What Shall Be Done with the Clifford Case* (1945) 45 Col. L. Rev. 111, 127-131.

¹⁵² *Helvering v. Clifford*, 309 U. S. 331, 336 (1940).

time retaining complete dominion and control over the income-producing factor of the business. The second pattern, and the one which is the most obvious invitation to *Clifford* doctrine application, is the situation in which the head of a family has placed an interest in a family partnership in trust for a member of his family, thereby nominally constituting the trustee or the beneficiary a partner in the family enterprise.

When the sweeping rationale of the *Clifford* case is considered in connection with attempted reallocations of income within a family unit,¹⁵³ it is not surprising to find that the contention has been made that the doctrine should apply in family partnership cases even though no trust device is used.¹⁵⁴ It would seem, however, that unless the

¹⁵³ It is perhaps a conservative estimate that since the *Clifford* case was decided, more than one hundred and fifty decisions have been handed down which bear on its general doctrine. The underlying theme in all of these cases has been, however, that the settlor of a trust will be taxed only in the situation in which he in effect remains the owner of the trust *res*. Moreover, taxpayers have long since learned to their sorrow that no argument limiting the *Clifford* doctrine to the original set of facts which formulated it will be accepted. Thus in *Commissioner v. Buck*, 120 F. (2d) 775 (C. C. A. 2nd 1941) a trust was created to last during the life of the settlor with no reversion unless the beneficiary predeceased him. The Court, applying the rationale of the *Clifford* doctrine rather than an analogy to its facts, found the settlor taxable. See also *Williamson v. Commissioner*, 132 F. (2d) 489 (C. C. A. 7th, 1942).

¹⁵⁴ *Justin Potter*, 47 B. T. A. 607 (1942) illustrates an early attempt to apply the *Clifford* doctrine to a family partnership pattern in which no trust device was used. In that case, the taxpayer, a member of a partnership which was composed of persons other than the members of his immediate family, made an irrevocable oral gift of part of his interest in the firm to his minor children. Thereafter the taxpayer managed and controlled the interests of the minors in the business in the same manner as he controlled his own interest. In this situation the Government took the position that the continued control by the father over the income-producing factor even after the gift was completed required that the rationale of *Helvering v. Clifford* be applied. In denying this contention the answer of the Board was to the effect that the control exercised by the father as a partner was merely that of a natural guardian of a ward's estate and was therefore not the type of control condemned in the *Clifford* case. In later decisions, however, the Tax Court has looked with more favor upon the applicability of the *Clifford* doctrine in family partnership cases involving somewhat similar facts. Thus, in *Francis E. Tower*, 3 T. C. 396 (1944) *Rev'd Tower v. Commissioner*, 148 F. (2d) 388 (C. C. A. 6th, 1945) the Court, by way of dictum, indicated that the continued domination and control by a husband of his business after the formation of a limited family partnership was sufficient for it to invoke the *Clifford* rule. In reversing the Tax Court, the Circuit Court of Appeals for the Sixth Circuit was content to place its decision on other grounds. However, in *Doll v. Commissioner*, 149 F. (2d) 239 (C. C. A. 8th, 1945) *Cert. Applied* June 19, 1945, the Circuit Court of Appeals for the Eighth Circuit, in determining that local law was inapplicable in family partnership cases, met the problem by stat-

case involved the use of a trust, such contentions only serve to muddy the waters further. The reason for this lies in the fact that if no trust is employed, the *Clifford* doctrine can only be used as a short cut in proving that no property was transferred from one member of a family to another, and as a result that no assets had been contributed to the firm by one or more of its partners. As pointed out above, this result has been reached in many of the cases by an examination of the gift for the purposes of determining whether or not the donor had surrendered all of the indicia of ownership and economic control over its subject matter.¹⁵⁵ In such cases, if the courts have been satisfied that no gift of property has been made by one member of a family to another, the partnership has been disregarded. The advocacy of the *Clifford* doctrine in such situations, therefore, does little more than encroach upon accepted methods of approach, and serves no useful purpose.¹⁵⁶

To be distinguished from the family partnership cases in which no trust device is used are those situations in which the taxpayer creates a family partnership and places the interest of one of the partners, a family member, in trust with himself or some third party as trustee. These patterns have been the object of *Clifford* doctrine approach on the theory that the trust provisions coupled with the terms of the partnership agreement point to the fact that

ing that such cases were to be considered with those in which there was an attempt to reallocate income within a family group. Having taken this position, the Court emphasized the *Clifford* approach and applied the test of whether or not the formation of the partnership made or effected any substantial change in the taxpayer's economic position.

¹⁵⁵ *Supra*, n. 67-76.

¹⁵⁶ But see Eisenstein, *Some Iconoclastic Reflections on Tax Administration* (1945) 58 Harv. L. R. 477, 497-498, in which the point is made that the *Clifford* doctrine, in theory, is broad enough to be used in all instances where legal formalities have been created as a refuge from surtaxes. Granted that this may be true, the question remains as to whether or not it is wise policy to abandon accepted methods of approach which have been found to be workable in favor of a new and uncertain doctrine that can at best result in the same end product. In this connection, the Tax Court has stated in *Robert P. Scherer*, 3 T. C. 77 (1944) that it did not believe that there was any reason to say that the decision in *Helvering v. Clifford* overruled the long line of cases dealing with family partnerships, or that its doctrine should be extended so far as to set aside the well established method of taxing partnership income to the respective partners and taxing it all to one partner because he exercised a high degree of managing control.

the taxpayer has not changed his economic position as a result of the organization of the firm. Actually, the end product which is sought in this type of case is the same as that in which no trust device is used, namely the taxing of income to the person who earns it without reference to the validity of the partnership for tax purposes. To the extent that this approach cuts across accepted methods which are in existence to determine this question, it is no more helpful in cases where a trust is used than it is where no trust has been employed.

There is, however, one feature inherent in the cases under discussion which might be said to justify the application of the *Clifford* principle. The basis for this distinguishing feature lies in the fact that the trust instrument, when coupled with the partnership agreement, may have the effect of pyramiding the sources of control retained by the taxpayer over partnership assets. In such situations, it should be no answer that a firm has been formed which would comply with all of the necessary requirements that must be present before a family partnership will be recognized for tax purposes. The examination should go farther, and should take into consideration the bundle of rights reserved by the taxpayer under the terms of the trust instrument. When these rights are added to those reserved to the taxpayer under the partnership agreement, the courts should be at liberty to apply the rationale of the *Clifford* case for the purposes of determining to whom the income, which is nominally owned by the trust, should be taxed.

In justifying the applicability of the *Clifford* doctrine to family partnership cases in which a trust device is used, the courts should keep two important factors in mind. In the first place, emphasis has been and should be placed on the character of the trust *res* in applying the rationale of the doctrine. It has been held, for instance, that if a taxpayer creates a trust in which the corpus is an interest in his business, and if that interest is never in fact delivered to the trustee but is retained in the enterprise subject to the complete dominion and control of the grantor, the

income nominally owned by the trust or beneficiary will be taxed to the grantor.¹⁵⁷ The second factor, one which has been referred to above, is that when considered together, the terms of the trust instrument and the partnership agreement may well furnish adequate grounds for holding the grantor taxable.¹⁵⁸ In such situations, a sound approach should call for a construction of the partnership agreement and the trust instrument together for the purposes of determining whether or not the transfer had affected materially the economic position of the taxpayer.¹⁵⁹

A review of the cases which have dealt with the problem under discussion will reveal the usual inconsistencies. For instance, before *Helvering v. Clifford* was decided, taxpayers were generally successful in meeting the Commissioner's contention that income realized by a partnership interest held in trust was taxable to them.¹⁶⁰ Thus,

¹⁵⁷ This point has recently been decided in *Tyson v. Commissioner*, 146 F. (2d) 50 (C. C. A. 8th, 1944). In that case the taxpayer, who conducted a small loan business, executed an irrevocable trust which named his wife trustee and his daughter beneficiary. The trust was to terminate when the daughter became twenty-one, and the entire corpus, which was an "interest" in the taxpayer's business, was to pass to her. Actually, nothing was delivered to the trustee, and the taxpayer conducted his business as he had always done, it being entirely optional with him whether any part of the profits could be withdrawn by the trustee. The Tax Court, Richard R. Tyson, T. C. Memo. Op., Dkt. 1165 (March 31, 1944), held that no completed gift had been made, and that the taxpayer remained taxable under Section 22 (a). This position was affirmed by the Circuit Court for the Eighth Circuit. See also *Whayne v. Glenn*, 59 F. Supp. 517 (W. D. Ky. 1945).

¹⁵⁸ It may be that this is one of the most overlooked points in all family partnership cases. If the quantum of control retained by the taxpayer is the touchstone in determining his taxability, it is reasonable to believe that all sources of that control should be examined. In family partnership cases, both the partnership agreement and the trust instrument are capable of containing provisions relating to control. While it may be true that in a given case, one or the other of these instruments might not, of itself, contain sufficient provisions relating to control to call for the continued taxing of the head of the family, taken together the instruments might far exceed the requirements set forth in the *Clifford* case. Courts should constantly be on guard, therefore, to prevent this type of pyramiding by a careful examination of the partnership agreement and the trust as parts of a single unit.

¹⁵⁹ In *H. G. Whittenberg, Sr.*, T. C. Memo. Op., Dkt. 2778 (Sept. 13, 1944), the Tax Court reached its conclusion by construing the partnership agreement with the terms of the trust instrument.

¹⁶⁰ In *M. A. Reeb*, 8 B. T. A. 759 (1927) the taxpayer created a trust for his minor daughter which named the taxpayer's wife trustee. The trustee was clothed with very broad general and discretionary powers in the discharge of her duties in the execution of the trust. On the day after the creation of the trust, the taxpayer formed a partnership in which his wife as trustee for the daughter was made a partner. Each

in *Rose v. Commissioner*,¹⁶¹ a family partnership was recognized for tax purposes even though the taxpayer transferred only a life interest in his business to himself as trustee for the benefit of his wife and two daughters and thereafter retained complete control over the trust *res* "as if he were the owner thereof".¹⁶² In a somewhat similar situation,¹⁶³ the Board refused to sustain a deficiency against the head of a family where an interest in his business was given to his wife as trustee for his two minor children, and where immediately thereafter the husband and wife individually and as trustees signed a partnership agreement which provided that the distribution of partnership income was to be made in the sole discretion of the taxpayer. However, the courts refused to sanction those situations in which income to be earned by a family partnership as distinguished from the assets of the firm itself were assigned to trustees for the benefit of a family member.¹⁶⁴ Such cases were held to be squarely within the *Leininger* doctrine.

Cases decided after the promulgation of the *Clifford* doctrine have not been uniform in the application of that doctrine to family partnership patterns in which trustees of a family trust or its beneficiaries have been made partners in a family business. In *Sidney Nathan et al*,¹⁶⁵ the taxpayers conveyed a portion of their partnership interest to themselves and their wives as trustees for their minor children and subsequently formed a limited partnership in which the wives, acting as trustees for the children, were

partner executed a note to the firm as a capital contribution, and these notes were paid off at the end of the first year from partnership profits. Broad powers of control were conferred on the taxpayer under the partnership agreement. The Board held that the Commissioner had erred in including the income of the minor's trust estate as a part of the taxpayer's income.

¹⁶¹ 65 F. (2d) 616 (C. C. A. 6th, 1933).

¹⁶² A large portion of the opinion in the *Rose* case dealt with the question of whether the facts under consideration could be distinguished from the facts in *Burnet v. Leininger*. Having distinguished the *Leininger* case, the Court adopted an ostrich-like attitude, refused to look ahead, and reversed the Board.

¹⁶³ Richard H. Oakley, 24 B. T. A. 1082 (1931).

¹⁶⁴ *Balkwill v. Commissioner*, 77 F. (2d) 569 (C. C. A. 6th, 1935) *Cert. denied* 296 U. S. 609 (1935).

¹⁶⁵ T. C. Memo. Op., Dkts. 102726, 102727, 102728, 102730 (May 14, 1943).

designated as limited partners.¹⁶⁶ The trusts were irrevocable, and were to last until the children reached the age of thirty-five, at which time an absolute distribution of corpus was to be made to the beneficiaries.¹⁶⁷ Broad powers of investment and discretionary powers of distribution of corpus and income were conferred upon the trustees. The Tax Court decided that the *Clifford* doctrine was inapplicable by isolating the trusts and in effect considering their terms independently from the broad powers of control retained by each of the partners under the partnership agreement. A similar approach was used in *Robert P. Scherer*¹⁶⁸ and a similar result was reached, although the Tax Court, had it seen fit to construe the trust instrument and the partnership agreement together, could have found that the aggregate amount of control retained by the taxpayer over the income-producing factor at least equalled that in some of the cases in which the *Clifford* doctrine had been successfully applied.¹⁶⁹

The theory advocating the application of the *Clifford* doctrine to family partnership patterns in which a family trustee or the trust beneficiary has been made a partner has made some headway in the Circuit Courts of Appeals. In *Losh et al. v. Commissioner*,¹⁷⁰ the doctrine was applied

¹⁶⁶ It will be noticed that the general partners in the *Nathan* case were not all members of an immediate family. Moreover, the new or limited partners were not related except by marriage. What weight this fact has and will have in the future is difficult to determine. However, the recognition of a new partner by an old member of the firm who is not related to the new member should be persuasive of the fact that the new firm was not formed entirely as a tax-saving measure.

¹⁶⁷ Provision was made, however, for a distribution of accumulated income to the beneficiaries who reached the age of twenty-one, and thereafter to pay to the beneficiaries income as it was earned.

¹⁶⁸ 3 T. C. 776 (1944).

¹⁶⁹ If the trust and partnership agreements are considered together in the *Scherer* case, the general picture presented is that a taxpayer has created an irrevocable trust for his minor children, in which he has named his wife as trustee, and in which he has designated an interest in his business as the trust *res*. The trust is to last until the beneficiaries reach the age of twenty-five, at which time it is to terminate and all accumulated income and corpus will go to them. However, the taxpayer has retained exclusive control over the business (and hence the trust *res*), and it is only within the sole discretion of the taxpayer that the profits of the business may be distributed. This amount of control over the distribution of trust income has led one court to invoke the *Clifford* doctrine. *Commissioner v. Buck*, 120 F. (2d) 775 (C. C. A. 2nd, 1941).

¹⁷⁰ 145 F. (2d) 456 (C. C. A. 10th, 1944).

to sustain a deficiency against a tax-payer who had conveyed an interest in his business of selling road oils and construction materials, to himself as trustee for his minor son under an "Agreement and Declaration of Trust and Partnership". This document gave the trustee absolute power of control and management over the trust estate, the unlimited power to make investments, and the power to spend the trust income for the comfort, education, training, support and welfare of the beneficiary. Both the Tax Court¹⁷¹ and the Circuit Court of Appeals had no difficulty in finding that the economic position of the taxpayer had not been changed by the trust and partnership agreements, and thus they held that the settlor remained taxable.¹⁷² However, in *Armstrong v. Commissioner*,¹⁷³ the Circuit Court of Appeals for the Tenth Circuit refused to follow the *Clifford* approach which had been applied in the Tax Court,¹⁷⁴ in a case in which the taxpayer had agreed to hold an interest in a family partnership which he had received as an heir from his father's estate in trust for his two minor children. The fact that the trustee was vested with and could exercise all of the powers and privileges of an owner over the trust estate in the same manner as an individual could exercise over his individually owned property was disregarded in favor of the conclusion that to tax the settlor "would be to say that a father cannot by deed of trust, no matter how absolute, deed property

¹⁷¹ A. R. Losh, 1 T. C. 1019 (1943) *Aff'd* Losh v. Commissioner, 145 F. (2d) 456 (C. C. A. 10th, 1944). It is interesting to note that the Tax Court stated in the course of its opinion that this case would be controlled by *Murphy Shannon Armstrong*, 1 T. C. 1008 (1943), and could be disposed of accordingly on the authority of *Helvering v. Clifford*. On appeal, the Circuit Court of Appeals reversed the Tax Court in the *Armstrong* case. *Armstrong v. Commissioner*, 143 F. (2d) 700 (C. C. A. 10th, 1944). In the *Losh* case, however, the Circuit Court of Appeals was not impressed by the similarity. *Losh v. Commissioner*, 145 F. (2d) 456, 458 (C. C. A. 10th, 1944).

¹⁷² The Court clearly defines the issues at the outset of its opinion where it states, at page 456:

The decision turns upon whether a partnership arrangement effected a change in the economic status of petitioners within the decision of the Supreme Court in *Helvering v. Clifford*, 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788.

¹⁷³ 143 F. (2d) 700 (C. C. A. 10th, 1944).

¹⁷⁴ *Murphy Shannon Armstrong*, 1 T. C. 1008 (1943).

to a child if he himself is the trustee and retains absolute control and management to the benefit of the estate".¹⁷⁵

Related to the question of the impact of the *Clifford* doctrine on family partnership patterns is the effect to be given in such cases to *Douglas v. Willcuts*¹⁷⁶ and *Helvering v. Stuart*.¹⁷⁷ This follows from the combination of the fact that in some instances income received by a family partner is or may be used to discharge obligations which would normally be considered as those of the head of the family¹⁷⁸ and the legal principle that income of a trust used to discharge the taxpayer's legal obligations remains taxable to him.¹⁷⁹ It has been held that if a beneficiary of a trust receives income unconditionally it is not taxable to the settlor merely because the beneficiary might use the funds for family support.¹⁸⁰ The same result has been reached where an individual has received unconditionally income from a family partnership although he has used or could use the money to satisfy legal obligations of the head of the family.¹⁸¹ This conclusion seems sound, especially in those cases not involving the trust device. Where a partnership interest is placed in trust thereby making the trustee or the beneficiary a partner, it is improbable that the settlor will remain taxable under Section 167(c)¹⁸²

¹⁷⁵ *Armstrong v. Commissioner*, 143 F. (2d) 700, 704 (C. C. A. 10th, 1944).

¹⁷⁶ 296 U. S. 1 (1935).

¹⁷⁷ 317 U. S. 154 (1942).

¹⁷⁸ Paul, *Five Years with Douglas v. Willcuts* (1939) 53 Harv. L. Rev. 1.

¹⁷⁹ *Douglas v. Willcuts*, 296 U. S. 1 (1935); *Helvering v. Schweitzer*, 296 U. S. 551 (1935) (per curiam); *Helvering v. Stokes*, 296 U. S. 551 (1935) (per curiam), *rehearing denied*, 296 U. S. 665 (1936); *Helvering v. Blumenthal*, 296 U. S. 552 (1935) (per curiam).

¹⁸⁰ *Suhr v. Commissioner*, 126 F. (2d) 283 (C. C. A. 6th, 1942). This case was decided before the *Stuart* case. For a discussion of whether or not it has survived, see Guterman, *The Stuart Case and its Aftermath* (1944) 57 Harv. L. Rev. 479, 486.

¹⁸¹ E. R. Ledbetter, B. T. A. Memo. Op., Dkt. 104852 (Jan. 19, 1942).

¹⁸² This section was amended by the Revenue Act of 1943 §134 to correct the result reached by the *Stuart* decision. It provides that "Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed."

or under the aftermath of the *Stuart* case.¹⁸³ However, while of itself not sufficient to invoke the doctrine of the *Douglas* and *Stuart* cases, the fact that the recipient of income from a family partnership uses the funds to discharge legal obligations normally carried by the head of a family is at least some evidence that no partnership was created, and that the parties merely have reallocated income within a given family unit.¹⁸⁴

Conclusion.

Although it has become axiomatic that each family partnership case must stand on its own merits, it does not follow that there is an absence of accepted methods of approach which may be used to determine whether a firm should be regarded for tax purposes. While the general outlines of these standards are clear in themselves, it is sometimes an arduous task to block in the entire picture with the conflicting facts and charges which are produced in a given controversy. The complexity of the problem lies, however, in the difficulty of determining the facts, a function which has been trusted, in the majority of tax cases, to a specialized and highly trained court. In con-

¹⁸³ In *Robert P. Scherer*, 3 T. C. 776 (1944) the Tax Court said (p. 798):

We know of no rule of law which would make a wife's income taxable to her husband merely because it is expended voluntarily, by agreement between herself and her husband, for household expenses of the family.

See also *Philip M. McKenna*, T. C. Memo. Op., Dkt. 4053 (Sept. 29, 1944); *Sidney Nathan et al.*, T. C. Memo. Op., Dkts. 102726, 102727, 102728, 102730 (May 14, 1943). However, see *A. R. Losh*, 1 T. C. 1019 (1943) *Aff'd* *Losh v. Commissioner*, 145 F. (2d) 456 (C. C. A. 10th, 1944) in which the Tax Court indicated that the facts under consideration were strong enough to invoke either the *Clifford* doctrine or the *Stuart* doctrine. The close connection between the rationale of the *Douglas* and *Stuart* cases and the *Clifford* doctrine is further illustrated by *Murphy Shannon Armstrong*, 1 T. C. 1008 (1943). On appeal, the taxpayer, ignoring the more far-reaching application of the *Douglas* case, sought reversal on the theory that the effect of the *Stuart* case had been overruled by Congress. Brief for Petitioner, pp. 51-58, *Armstrong v. Commissioner*, 143 F. (2d) 700 (C. C. A. 10th, 1944). The Court, in reversing, took the position that the father was not liable for the support of his son at law school when he was able to support himself. Moreover, the entire impact of the *Stuart* case may not have been eliminated by Congress. See *Guterman, The Stuart Case and its Aftermath* (1944), 57 Harv. L. Rev. 479, 499-506. The analogy between the *Stuart* and *Clifford* cases is discussed in *Sprecher, From Clifford to Stuart* (1943) 31 Geo. L. J. 477.

¹⁸⁴ This would seem to be the actual approach employed in *Murphy Shannon Armstrong*, 1 T. C. 1008, 1018 (1943).

sidering the general problem all of the evidence should be weighed, but the substantive effect of local law provisions or decrees should be ignored. The *Clifford* doctrine should be considered if trust provisions have been added to other sources of control retained by the taxpayer, but should be ignored in cases in which this is not true. And most important of all, parties who have formed family partnerships for the sole purpose of reducing their personal taxes without making corresponding changes in their economic position should pay their deficiencies and stay out of court. In so doing, the time, energy and resources of the Government as well as of the taxpayer would be saved for more commendable undertakings than the trial of a tax case which can have only one answer.